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Pension ANALYST

Important Information Legislation June 2007

Pension Protection Act of 2006 Requires Major Changes to Multiemployer Defined Benefit Plans in 2008 and Beyond

This is one of a series of *Pension Analyst* publications providing information on specific aspects of the 2006 pension reform legislation affecting defined benefit plans. This publication focuses on those changes that are effective in 2008 and beyond. An earlier publication discussed those provisions that became effective in 2007 and prior years. Separate publications discuss the changes affecting single-employer plans, governmental plans and nonelecting church plans in 2008 and beyond.

WHO'S AFFECTED These developments affect sponsors of and participants in qualified multiemployer defined benefit plans.

BACKGROUND AND SUMMARY On August 17, 2006, President Bush signed into law the Pension Protection Act of 2006 (PPA). The 1000 pages of this new law contain major provisions for comprehensive pension reform and introduce substantial changes designed to enhance retirement security of American workers and their families.

For multiemployer defined benefit plans, PPA establishes new funding requirements. PPA creates additional funding rules for plans that are in endangered or critical status. PPA also introduces enhanced disclosure requirements to participants regarding a plan's funding status. Finally, PPA requires defined benefit plans to offer a joint and 75% survivor annuity option.

This *Pension Analyst* discusses the PPA provisions that apply to multiemployer defined benefit plans in 2008 and later years in an effort to help plan sponsors determine the future actions needed to keep their plans in compliance with ERISA and the Internal Revenue Code. Some of the items do not require plan sponsors to make plan amendments. Other provisions require sponsors to amend their plans.

ACTION AND NEXT STEPS The PPA provisions affect plan funding, design and administration. Plan sponsors should carefully read the information contained in this *Pension Analyst* and should discuss the new law's impact on their plans with their enrolled actuary and legal counsel. Prudential Retirement's enrolled actuaries are well prepared to respond to your inquiries regarding the effect of the new law on your plan.

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Funding Rules

PPA changes the funding rules for multiemployer defined benefit plans to include:
- Revisions to amortization periods;
- Changes in funding waivers; and
- Revisions to the reasonableness requirement for actuarial assumptions.

Amortization Periods

Effective for plan years beginning on and after January 1, 2008, PPA reduces the amortization period from 30 years to 15 years for certain charges and credits to the funding standard account. It does not change the amortization period for experience gains and losses, which is already set at 15 years. The new rules do not apply to amounts being amortized under current law rules, so these amounts do not have to be recalculated.

Amortization Extensions

For plan years beginning on or after January 1, 2008, plan sponsors may receive an automatic extension for up to five years to amortize any unfunded past service liability, investment loss or experience loss. While the plan sponsor must apply for this extension, the IRS must grant the extension request. To obtain the extension, the plan's enrolled actuary must certify that:
- Without the extension, the plan would have an accumulated funding deficiency in the current plan year or any of the 9 succeeding plan years;
- The plan sponsor has adopted a plan to improve the plan's funding status;
- The plan is projected to have sufficient assets to pay its expected benefit liabilities and other expenses, taking the extension into consideration; and
- The required advance notice to affected parties has been provided.

After December 31, 2014, this extension will still be available but will not be automatic.

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A plan sponsor may apply for an additional extension of the amortization period for up to five years. To receive the additional extension, the plan must show that it would provide adequate protection for participants and their beneficiaries, and denial of the extension would:

- Be adverse to participants' interests; and
- Substantially risk the future of the plan or cause a substantial curtailment of benefits or employee compensation.

The additional extension is not automatic and the IRS must approve or deny the request within 180 days after the application is submitted. The IRS must provide specific reasons for the denial of an extension request.

Funding Waivers

A plan sponsor may apply for a funding waiver for a year if:

- 10% or more of the employers contributing to or under the plan cannot satisfy the minimum funding standard for a plan year without substantial business hardship; and
- Meeting the funding standard would be adverse to participants' interests.

To receive a funding waiver, the sponsor must provide an advance notice of the application for a waiver to all participants, beneficiaries, alternate payees, employer organizations representing participants and the Pension Benefit Guaranty Corporation (PBGC). The notice must describe the plan's funding status. However, the IRS cannot waive the minimum funding status for more than five of any 15 consecutive plan years.

If a funding waiver is granted, the plan may not be amended during the waiver period to increase benefits, change benefit accruals or change vesting rates in a manner that increases plan liabilities. If a plan amendment that increases liabilities is adopted while a waiver is in effect, the waiver no longer applies on or after the date of the amendment. These plan amendment restrictions do not apply to amendments required to maintain the plan's tax qualified status or which provide only a de minimis increase in benefits.

Reasonableness of Actuarial Assumptions

For plan years beginning after 2007, each actuarial assumption and method used to determine cost, liabilities, interest rates, and other funding factors must be reasonable, taking into account the plan's experience and reasonable expectations. The actuarial assumptions must offer the actuary's best estimate of anticipated plan experience.

Plans in Endangered or Critical Status

PPA imposes additional funding and notice requirements for multiemployer plans in endangered or critical status. These requirements are intended to ensure that underfunded plans address funding issues. There are three levels of endangered or critical status under these new rules:

- "Endangered status;"
- "Seriously endangered status;" and
- "Critical status."

Each year, a plan's enrolled actuary must certify to the plan's funding status within a specified timeframe. Sponsors of plans that are in endangered, seriously endangered, or critical status must notify interested parties of the situation and adopt either a funding improvement plan or a rehabilitation plan. Plan design changes during periods that a plan is in endangered, seriously endangered, or critical status are limited and

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excise taxes apply if the contributions required under a funding improvement plan or rehabilitation plan are not made.

Endangered Status

A multiemployer plan is in "endangered status" if the plan is not in critical status and the:

- Plan's funded percentage is less than 80%; or
- Plan has an accumulated funding deficiency for the current plan year or a projected accumulated funding deficiency for any of the next six plan years.

A plan is in "seriously endangered status" if both of the above situations exist.

An endangered plan must adopt a funding improvement plan (FIP) within 240 days after the due date of the enrolled actuary's certification that it is endangered. The FIP must:

- Reduce the plan's unfunded percentage by at least 33% before the end of a 10-year funding improvement period; and
- Eliminate any accumulated funding deficiency for any plan year during the FIP.

Seriously endangered plans must satisfy more stringent requirements.

Sponsors of affected plans must update the FIP every year and file the update with the plan's Form 5500.

While in endangered status, plan sponsors cannot accept any collective bargaining agreements that:

- Lower contributions for any participants;
- Suspend contributions for any period of service; or
- Exclude younger or newly hired employees from plan participation;

In addition, the sponsor cannot amend the plan to increase plan liabilities by increasing benefits, changing accruals or changing the vesting rate unless the amendment is necessary to maintain the plan's qualified status or is required by law, and is consistent with the terms of the funding improvement plan.

A contributing employer that does not make the contributions required by the FIP, is subject to an excise tax equal to 100% of those contributions.

Critical Status

A plan is in critical status if it meets one of the following criteria:

- The plan is less than 65% funded and (1) will have a projected funding deficiency within five years, or (2) it is projected to be unable to pay benefits within seven years; or
- The plan's normal cost for the current plan year, plus interest for the current plan year on unfunded benefit liabilities exceeds the present value of the reasonably anticipated employer contributions for the current plan year, plus the present value of nonforfeitable benefits of active participants and the plan (1) has an accumulated funding deficiency for the current plan year, or (2) is projected to have an accumulated funding deficiency for any of the next four succeeding plan years; or
- The sum of the market value of plan assets plus the present value of the reasonably anticipated employer contributions for the current plan year and each of the four succeeding plan years is less than the present value of all benefits projected to be payable under the plan during the current plan year and each of the four succeeding plan years.

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A plan in critical status must implement a rehabilitation plan, which allows the plan to emerge from critical status within a 10-year period. The rehabilitation plan must be adopted no later than 240 days after the due date of the enrolled actuary's certification that it is in critical status. The rehabilitation plan may include reductions in plan expenditures, reduction in future benefit accruals, and increases in contributions.

Plans in critical status are subject to certain restrictions on:

- Paying lump sum benefits; or
- Adopting amendments that reduce contributions or increase benefits or future benefit accruals.

To encourage employers to negotiate with bargaining units to adopt a schedule of benefits and contributions consistent with the rehabilitation plan, employers with collective bargaining agreements that are inconsistent with the rehabilitation plan must pay a surcharge that is equal to:

- 5% of the required contribution for the first year that a plan is in critical status; and
- 10% of the required contribution for each subsequent year that the plan is in critical status.

A contributing employer that does not make the contributions required by the rehabilitation plan is subject to an excise tax equal to 100% of those contributions.

Under PPA, the funding rules for plans in endangered or critical status will sunset after December 31, 2014. However, funding improvement plans and rehabilitation plans in effect on that date will remain in effect.

Actuarial Certification

Within 90 days of the beginning of each plan year, the plan's enrolled actuary must certify to the IRS and the plan sponsor whether the plan is in endangered or critical status. The actuary must also certify whether the plan is making progress in meeting the requirements of the FIP or rehabilitation plan. If the actuary fails to certify the plan's status by the required date, the plan is subject to a penalty of up to $1,100 per day. It is important that sponsors submit plan information as soon as possible in order for the plan's enrolled actuary to complete the plan valuation and actuarial certification.

If Prudential Retirement does not provide actuarial advisory services but does provide benefit payment or document services for your plan, plan sponsors will need to provide a copy of the actuarial certification to Prudential.

Notice Requirements

Within 30 days of the certification that a plan is in endangered or critical status, the plan sponsor must notify participants, beneficiaries, collective bargaining parties, the PBGC and the Department of Labor (DOL). The DOL has been instructed to create a model notice and to provide guidance regarding the form and manner in which the notice is to be given.

Reporting and Disclosure Requirements

Plan Funding Notice

Effective for plan years beginning on or after January 1, 2008, PPA requires annual funding notices to provide additional information. PPA also revises the timing for providing these notices.

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Under the new rules, plan administrators must provide the annual funding notice within 120 days of the end of the plan year to which it relates. In the case of a small plan (i.e., a plan covering less than 100 participants), the notice must be provided by the filing due date of the annual Form 5500 (i.e., within seven months after the end of the plan year unless the due date for the annual report is extended).

The funding notice must include the following new information:

- The number of participants;
- A statement of funding policy and asset allocation (as a percentage of total assets) as of the end of the plan year;
- An explanation of any plan amendment, scheduled benefit increase or reduction, or other known event taking effect in the current plan year and having a material effect on plan liabilities or assets for the year);
- A statement on the plan's level of assets and liabilities and the corresponding funding status for the plan year and the preceding two years;
- A summary of ERISA's plan termination rules;
- A general description of the PBGC's guaranteed benefits;
- An indication if the plan is endangered or critical status and how a person may request a copy of the FIP or rehabilitation plan;
- A statement that a copy of the plan's Form 5500 annual report is available upon request, through the Department of Labor's website, or through an Intranet website maintained by the plan sponsor; and
- Any additional information that the plan administrator elects or includes that is not inconsistent with the DOL regulations.

The notice must be written in a manner that can be understood by the average plan participant and may be delivered in written, electronic, or other form that is reasonably accessible. PPA directs the DOL to provide a model notice, satisfying these requirements, by August 17, 2007.

As a result of the expanded annual funding notice requirement, PPA has repealed the requirement that defined benefit plans provide Summary Annual Reports (SARs) to plan participants. The repeal is effective for plan years beginning after December 31, 2007. For plan years beginning before January 1, 2008, SARs are still required.

Additional Form 5500 Disclosures

Effective for plan years beginning on or after January 1, 2008, PPA requires the annual Form 5500 return/report to include additional information. PPA also requires that the actuarial statement filed with the annual report contain a statement explaining actuarial assumptions and methods used in projecting future retirements and forms of distribution under the plan.

In addition, the Form 5500 filing for a multiemployer defined benefit plan must indicate:

- The number of employers obligated to contribute;
- A list of employers that contributed more than 5% of the total contributions for the plan year;
- Whether the plan was in critical or endangered status; and
- If any employer withdrew from the plan along with the total withdrawal liability assessed.

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Electronic Display of Annual Report

Effective for plan years beginning on or after January 1, 2008, PPA requires plan administrators to electronically file basic plan information and actuarial information from the Form 5500 to the DOL. Within 90 days after filing, the DOL must display this information on its Internet website. Within the same time period, the plan sponsor or administrator must also display this information on an Intranet website.

The DOL has recently indicated that the requirement to file the Form 5500 electronically will be effective for plan years beginning on or after January 1, 2009, rather than January 1, 2008. It is unclear how this delay will affect this PPA requirement, if at all.

New Annual Reporting Requirement

For plan years beginning on and after January 1, 2008, multiemployer plan administrators must provide a new report to each organization representing participants (i.e., union) and each contributing employer within 30 days of the due date (including extensions) for filing the plan's Form 5500.

The report must contain information, such as:

- A description of the contribution schedules and benefit formulas under the plan;
- The number of employers obligated to contribute to the plan;
- A list of the employers that contributed more than 5% of the total contributions to the plan;
- Whether the plan was in critical or endangered status and, if so, include a list of the actions taken to improve its funding status;
- The number of employers that withdrew from the plan during the preceding plan year;
- Whether the plan sought or received an amortization extension for the year; and
- A statement of the right, upon written request, to receive copies of the Form 5500, summary plan description and summary of material modifications.

PPA requires the DOL to publish a model annual report by August 16, 2007.

Access to Multiemployer Plan Information

PPA requires a multiemployer plan administrator to provide a copy of the following plan documents, upon written request, from a participant, a beneficiary, an organization representing participants, or a contributing employer:

- Any periodic actuarial report for any plan year that has been in the plan's possession for at least 30 days;
- Any quarterly, semi-annual, or annual financial report prepared for the plan by any plan investment manager, adviser or other fiduciary which has been in the plan's possession for at least 30 days; and
- Any application filed with the IRS requesting an amortization extension and the result of such application.

The information requested:

- Must be provided within 30 days after the request;
- May be in written, electronic, or other form to the extent the form of delivery is reasonably accessible to the person making the request; and

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- Shall not include any information individually identifiable to any participant, employee, fiduciary or employer nor reveal any proprietary information regarding the plan, any employer, or any service provider.

In addition, PPA requires that a multiemployer plan, upon written request from any contributing employer, provide a notice stating:

- The estimated amount of the employer's potential withdrawal liability if the employer withdrew on the last day of the plan year preceding the date of the employer's request; and
- An explanation of how the estimated liability was determined, including actuarial assumptions and methods used to determine the value of plan liabilities and assets and the data regarding unfunded vested benefits.

In general, the notice of potential withdrawal liability must be provided within 180 days after the request is made and may be provided in written, electronic, or other form of delivery that is reasonably accessible to the person making the request. However, an employer may not request more than one notice during any 12-month period and a reasonable charge may be made for the cost of providing the notice.

A plan may be subject to a civil penalty of not more than $1,000 per day for each failure to comply with the either of the two new notice requirements described above.

Also for plan years beginning on or after January 1, 2008, multiemployer plans must provide a notice of benefit accrual reduction ("204(h) notice"), when applicable to contributing employers. Under prior law, only participants, alternate payees and organizations representing employees were required to receive this notice.

DB(k) Plan Design

Effective for plan years beginning in 2010, PPA allows certain employers to establish "eligible combined plans," more commonly known as "DB(k) plans." This plan design is only available to employers with fewer than 500 employees when the plan is established. At this point, it is not clear how the 500 employee rule will apply to a multiemployer plan (i.e., on an employer-by-employer basis, or to the plan as a whole).

Under the new law, a DB(k) plan is:

- Funded through a single trust with a single plan document;
- Required to file just one Form 5500;
- Exempt from the top-heavy rules (which only apply to non-collectively bargained employees covered by a multiemployer plan); and
- Deemed to satisfy the ADP and ACP tests (when applicable).

Under this plan design, the defined benefit portion must provide either:

- A benefit equal to 1% of final average compensation for each year of service up to a maximum of 20 years; or
- A cash balance plan that increases its benefit with the participant's age.

Benefits under the defined benefit portion must be 100% vested after three years of service.

The defined contribution portion must provide:

- Automatic enrollment with a contribution of 4% of pay;

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- Employer matching contribution equal to 50% of the first 4% of employee deferrals; and
- 100% immediate vesting for matching contributions.

Nonelective employer contributions to a profit sharing feature in the plan are permitted but not required. However, they must vest after 3 years of service.

Additional Distribution Rules

Direct Rollover to Roth IRA

Prior to January 1, 2008, plan participants may roll over distributions from a tax-qualified retirement plan to a traditional individual retirement arrangement ("IRA"), but not to a Roth IRA. Distributions from a traditional IRA may be rolled over to a Roth IRA if the taxpayer has a modified adjusted gross income (AGI) of $100,000 or less.

Beginning January 1, 2008, plan participants may roll over distributions from a tax-qualified retirement plan directly into a Roth IRA, provided the taxpayer's AGI is $100,000 or less. In 2010, this $100,000 threshold is repealed as a result of the Tax Increase Prevention and Reconciliation Act.

Qualified Optional Survivor Annuity

Defined benefit plans must provide benefits in the form of a qualified joint and survivor annuity (QJSA). A QJSA is an annuity for the life of the participant, with a survivor annuity for the life of the spouse, which is not less than 50% (and not more than 100%) of the amount of the annuity payable during the joint lives of the participant and his or her spouse.

Effective for plan years beginning on or after January 1, 2008, defined benefit plans must offer a new qualified optional survivor annuity (QOSA), which is a joint annuity with a continuation of either 50% or 75% of the amount payable to the participant. A plan must offer a:

- 75% survivor annuity option if it currently offers a QJSA with less than 75% continuation; and
- 50% survivor annuity option if it currently offers a QJSA with a survivor continuation percentage equal to or greater than 75%.

Collectively bargained plans have a delayed effective date which is the earlier of:

- The later of January 1, 2008, or the last date on which an applicable collective bargaining agreement terminates (without regard to extensions) after August 17, 2006; or
- January 1, 2009.

Until additional guidance is issued, it is unclear how the different effective dates will apply when a plan covers both collectively bargained employees and non-collectively bargained employees.

Minimum Lump Sum Value

PPA requires plans to use an interest rate for determining the minimum value of a lump sum payment and certain other optional forms of payment that is based upon a three-segment, modified yield curve, similar to the rate used for determining liabilities. This interest rate is determined by the period (i.e., segment) in which the lump sum benefit is paid as follows:

- 0-5 years from the first day of the plan year;
- 5-20 years from the first day of the plan year; or

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- More than 20 years from the first day of the plan year.

These new rates are determined without the 24-month averaging that applies to the rate used for determining liabilities and will be phased in over five years beginning in 2008.

Increased Bonding Requirement

ERISA generally requires every plan fiduciary and plan official who handles funds or other plan property to be bonded. Effective for plan years beginning on or after January 1, 2008, PPA increases the maximum bond amount from $500,000 to $1 million in the case of a plan that holds employer securities.

Missing Participants

If the plan administrator of a terminating single-employer defined benefit plan cannot locate a participant after a diligent search, the plan administrator may satisfy distribution requirements only by purchasing an annuity from an insurer or transferring the participant's benefit to the PBGC. If the benefit is transferred to the PBGC, the agency will hold the benefit as trustee until the PBGC locates the missing participant and distributes the benefit.

PPA now extends the PBGC's missing participants program to multiemployer defined benefit pension plans. This provision is effective for distributions made after the PBGC issues final regulations.

Next Steps

Prudential Retirement will continue to monitor the IRS, PBGC and DOL's published guidance regarding these new rules. Several employer groups have recently asked Congress to delay the effective date of the plan funding rules, but for now, we have to assume that plans will have to comply with the new rules beginning in 2008. We will keep you informed as additional guidance is made available that clarifies the PPA provisions discussed in this *Pension Analyst.* Hopefully, any guidance will provide examples illustrating how the new requirements apply in specific situations.

In general, PPA plan amendments do not have to be adopted until the last day of the 2009 plan year. If Prudential provides document services for your plan, we will work with you to provide your PPA amendment, as well as the related Summary Plan Description.

If you have questions about the new funding rules or actuarial certification requirements, you should contact the plan's enrolled actuary. If you have questions about how the new distribution rules affect your plan and the need for plan amendments, you should contact your document provider or your Prudential Retirement representative. Of course, plan sponsors should always be sure to involve the plan's enrolled actuary when considering any plan design changes, since those changes may affect plan funding.

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Summary of Pension Protection Act Provisions Effective On or After January 1, 2008 For ERISA Multiemployer Defined Benefit Plans

Changes Effective in 2008

- Funding rules
- Endangered or critical plan funding rules
- Reporting and disclosure rules
- Direct rollover to Roth IRA
- Qualified Optional Survivor Annuity (QOSA)
- Increased bonding requirements

Changes Effective in 2010

- DB(k) plan design

Pension Analyst by Prudential Retirement
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