Qualified Retirement Plans: “The Three Pronged Effect”

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Types of Qualified Retirement Plans

- Defined Benefit Pension Plans
- Defined Contribution Plans

Defined Benefit Pension Plans (“DB Plans”)

- What is a Defined Benefit Pension Plan?
- Traditional
- X-Tested (or Tiered Benefit Formulas)
- 412 (i)
- Cash Balance

Defined Contribution Plans (“DC Plans”)

- 401(k) vs Profit Sharing (“PS”)
  - EE Deferrals
  - ER Match
  - ER discretionary PS
- 2010 Limits ($49,000 vs $54,500 if age 50 or older)
- Allocation Types
  - Comp to Comp
  - Integrated
  - Age Weighted
  - X-Tested or Tiered Allocation or New Comparability

Prong 1

What is the Pension Protection Act of 2006 ("PPA") and why worry about it in 2010?

- New IRC Sections (Single Employer Plans)
  - 430 – Minimum Funding Standards
  - 436 – Funding Based Limits

Section 430 – Minimum Funding Standards

- Higher Minimum Required Contributions
  - Shorter periods (7 years) to fund unfunded liabilities called “shortfalls”. Previously could have paid unfunded liabilities off in 30 years.
  - Required to use IRS pre-determined “segment interest rates” based on 30-year corporate bond rates which may be much lower than what the Actuary could have assumed in prior years (i.e. 6%, 7%, 8%)
  - Required to use IRS pre-determined mortality tables. The Actuary used to be able to pick from many different mortality tables which produced lower minimum required contributions.
- Less Flexibility by the Actuary
- Prior Credits may need to get used up faster – “burned”

Section 436 – Funding Based Limits

- Increased Benefit Limits at Retirement Age
  - 2008 Limit - $185,000 per year for RA 62 to 65
  - 2009 Limit - $195,000 per year for RA 62 to 65
  - 2010 Limit - $195,000 per year for RA 62 to 65
- Lower "Segment Rates" together with using up prior credits generates much higher maximum deductions
- No more Current Liability Full Funding Limitations under OBRA

Additional Certifications and Notifications

- AFTAP – Adjusted Funding Target Attainment Percentage
  - Above 80 %
    - No restrictions
  - Between 60 % to 80%
    - Plan cannot be amended to increase benefits
    - Lump sum payments are limited to ½ of the benefit payable for those participants whose benefits are > $5,000
  - Below 60%
    - Benefits frozen
    - Plan cannot be amended to increase benefits
    - No lump sum payments can be made
    - Notification of restrictions must be provided to the plan participants within 30 days of certification date
- Restrictions remain in effect until the plan's AFTAP goes above 80%
- Failure to comply with these restrictions and notification requirements could jeopardize the plan's tax-exempt ("qualified") status

Additional Certifications and Notifications (cont'd)

- Annual Funding Notice ("PBGC")
  - If plan falls under the Pension Benefit Guaranty Corporation ("PBGC") insurance program, an additional Annual Funding Notice ("AFN") must be provided to plan participants
  - Prior 3 years funded status of the plan
  - Percentage breakdown of assets by category

- PPA Election Form
  - Asset Valuation Method
  - Discount Rates
  - Mortality Assumptions
  - Voluntary Election to reduce certain credits
  - Quarterly Contribution Offsets
  - Amendments
  - PBGC Premium Method

Prong 2

- Effects of the Market Crash of Late 2008 and Early 2009
  - Much larger MRC (“Minimum Required Contribution”)
  - Much larger maximum contribution deductions
  - Terminate DB plans that were previously overfunded
  - Payout of benefits to terminated employees when market is low may delay the turnaround time for a plan’s investment to rebound when market improves
  - Long-term effect

Prong 3

- Effects from a poor business climate
  - Cannot meet the MRC
  - Possible funding deficiencies
    - Penalties
    - Increased risk for plan audit
  - Need to terminate plan
    - Additional costs
    - All plan participants become 100% vested
    - Pay out plan participants when plan asset value is low
    - Additional costs to set up a new plan if business climate improves in near future

What Are Businesses Doing With Their Retirement Plans?

- Overfunded Plans
  - May not be overfunded any longer
  - Compensate spouse or other family member (small businesses)
  - Transfer owners' benefits to new DC plan, if eligible to do so
- Underfunded Plans
  - If company is profitable, may be able to make large deductible contributions, larger than ever
  - Terminate now and either transfer to a new DC plan or to an IRA
  - Transfer owner's benefits to a new DC plan, if eligible to do so
  - Freeze benefits and wait until the economy climate improves
    - Reducing current funding requirements
    - Allowing plan assets to catch up to plan liabilities

Where Are We Headed?

- Until the economy turns around, less new qualified plans being created. Too costly for the Employer
- Great time for profitable businesses to set up plans and take advantage of huge tax deductible contributions
- Resurgence of Defined Benefit Pension Plans with increase in tax rates, improved economy and more profitable businesses.
- Defined Benefit Pension Plans are still one of the last great deductions and Asset Protection methods available.