

Then and Now: **Pension Law Reforms Impact DB Funding**

In the wake of the *Pension Protection Act* and the *Worker, Retiree and Employer Recovery Act of 2008*, employer-sponsored benefit plans are being impacted by what many consider to be the most comprehensive reform of pension law since the inception of ERISA.

The Big Picture

The *Pension Protection Act* (PPA) seeks to bring stability to the nation's network of pension funds as a growing number of plans become underfunded and, in some cases, unable to meet their pension obligations. At the core of PPA is a host of new rules imposing stricter funding requirements for both single- and multi-employer defined benefit plans.

The *Worker, Retiree and Employer Recovery Act* (WRERA) goes one step further, providing technical corrections to PPA — chiefly, emergency funding relief for plan sponsors. In particular, WRERA frees cash-strapped employers from having to make significantly increased contributions during a time of national economic crisis.

PPA and WRERA affect both plan funding and administration, so plan sponsors will need to take action to keep their plans in compliance. In some cases, this may include amending the plan.

Playing Catch-up With Funding

In general, PPA legislation requires plans to be fully funded on an ongoing basis. Less-than-fully-funded plans are required to catch up to full funding by making level installment payments amortized over seven years.

Severely under-funded plans may be classified as “at-risk” and subject to stricter funding requirements. At-risk plans are those that were less than 80 percent funded in the preceding year, using general funding rules, *and* less than 70 percent funded when counting the plan's “at-risk liabilities” (liabilities determined as though all employees eligible to retire in the next 10 years will retire at the earliest possible time). Note that plans with less than 500 participants are exempt from these “at-risk” standards.

Pre-PPA: The “funding target” for most pension plans was 90 percent of the plan's current benefit liability.

Post-PPA: PPA sets a plan's funding target at 100 percent of the present value of all benefit liabilities accrued to date. The 100 percent funding target is phased in over four years, with plans generally expected to meet these interim targets:

- 2008 — 92 percent
- 2009 — 94 percent
- 2010 — 96 percent
- 2011 — 98 percent (100 percent thereafter)

Post-WRERA: Under-funded plans enjoy significant relief under WRERA. The act includes a provision allowing plans that fall below the set target funding percentage for any year to elect to retain the same target and not jump to 100 percent. For example, plans that were less than 92 percent funded in 2008 would have their shortfall estimated relative to 92 percent.

Phasing In New Actuarial and Asset Value Assumptions

PPA requires the use of actuarial and asset value assumptions that more precisely reflect a plan's actual liabilities and investment experience.

Pre-PPA: Plan sponsors calculated benefit liabilities using a discount rate chosen by the plan's actuary and a mortality table specified by the Treasury Department.

Post-PPA: Plans must now value their pension liabilities using three different rates based on a modified yield curve of investment-grade corporate bonds. The rates correspond to different time horizons for paying out plan benefits:

- A short-term rate is applied for benefits expected to be paid in the next five years.
- A medium rate is applied for benefits expected to be paid in five to 20 years.
- A long-term rate is applied for benefits expected to be paid after 20 years.

PPA and WREERA also seek to minimize problems of plan underfunding that occurred when the investment value of plan assets was overstated.

Pre-PPA: To help compensate for market fluctuations, plan assets were allowed to be “smoothed” by averaging their fair market value over a period of up to five years.

Post-WREERA: Pension plans are allowed to “smooth” out their unexpected asset losses. The new law permits employers to “smooth” the value of pension plan assets over 24 months instead of having to apply the mathematical average that Treasury requires. This change will soften the accounting of 2008 plan losses.

Increased Deductible Contributions

To encourage faster funding, the PPA increases the maximum deductible contribution amount that plans may take.

Pre-PPA: Employers were allowed a tax deduction for plan contributions up to 100 percent of a plan's current funding liability. Contributions above that amount were subject to a 10 percent penalty tax.

Post-PPA: Beginning in 2008, deductible contributions may be made up to an amount equal to the funding target, normal costs and a “cushion account” equal to 50 percent of the target liability account, plus accountability for projected compensation over the value of the plan assets.

Relief for Multi-employer Plans - WREERA also provides relief for multi-employer plans.

Pre-WREERA: Plans in “endangered” or “critical status” were required to adopt a funding improvement or rehabilitation plan.

Post-WREERA: While troubled plans must still adopt a funding improvement or rehabilitation plan, WREERA allows them to “freeze” their plan status for one year — effectively freezing for one year the terms of any funding improvement or rehabilitation plan adopted during the previous plan year.

Pre-WREERA: Plans were generally required to bring their funded position up to statutory standards within a correction period, typically 10 years or 15 years.

Next Steps

Plan sponsors should carefully evaluate these changes under the *Pension Protection Act*, as revised by the *Worker, Retiree and Employer Recovery Act*, to determine if plan administrative or funding changes are required.

If you have questions about the new funding rules or actuarial certification requirements, please contact our office.

Employee Benefits Advisor is produced quarterly by Bober Markey Fedorovich's Employee Benefit Plans Services Team. If you would like additional information about the services we provide, please call or email our team leader, James E. Merklin, CPA, CFF, CFE, M.Acc. at (330) 762-9785 or jmerklin@bobermarkey.com.

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BMF Partner and Practice Leader Jim Merklin appointed to national panel of employee benefit plan audit experts



Bober Markey Fedorovich (BMF) is pleased to announce James E. Merklin, CPA, CFF, CFE, partner, has been appointed to the national Employee Benefit Plans Expert Panel (EP) of the American Institute of Certified Public Accountants (AICPA). The EP is a highly selective group comprising 12 of the top audit and accounting experts from across the United States. The group deals with issues of importance to the employee benefit plan (EBP) audit industry.

Jim is director of the firm's EBP audit practice and has nearly 25 years of audit experience in working with benefit plans and their corporate sponsors. This appointment recognizes his contributions to enhancing the audit and accounting for benefit plans. As a member of the EP, Jim will have direct involvement in modification of guidance that CPAs across the country use in conducting benefit plan audits.

The objectives of the EP include:

- Representing the public interest and members of the AICPA through liaison activities with various industry groups and regulators
- Identifying financial reporting and auditing issues, and working with various bodies toward resolutions
- Advising and assisting in the development of AICPA products and services relating to the employee benefit plans industry

Jim also serves as a member of the AICPA's 403(b) Plan Task Force and is just finishing up his third term as a member of the AICPA's Employee Benefit Plans Audit Quality Center Executive Committee. He also chairs the EBP Committee for PKF North American Network. As well, he serves on the EBP Conference planning committee for the Ohio Society of CPAs and is a frequent speaker at local and national presentations. He is scheduled to present *Fraud in the Current Economy* at the AICPA's EBP conference in December in Washington D.C.

Bober Markey Fedorovich conducts an extensive number of benefit plan audits for both smaller companies as well as Fortune 100 companies.