Technical Update 08-4: Minimum Lump Sum Assumptions for Single-Employer Plans that Terminate in a Plan Year Beginning On or After January 1, 2008

December 31, 2008

This Technical Update expands guidance provided in Technical Update 07-3 on lump sum valuation issues for single-employer plans that terminate in a standard termination pursuant to ERISA section 4041 [1]. This Technical Update applies to plans that terminate on or after the effective date of certain amendments to the law as enacted by the Pension Protection Act of 2006 ("PPA 2006"). It provides guidance on how to apply the PPA 2006 changes in the interest rate and mortality table used in calculating minimum lump sum amounts.

I. Background

Section 417(e)(3) of the Internal Revenue Code ("Code") and the related regulations provide, with respect to a defined benefit plan, that the present value of any accrued benefit and the amount of any distribution, including a lump sum, must not be less than the amount that is actuarially equivalent to the life annuity payable to the participant at normal retirement, determined using the "applicable interest rate" and the "applicable mortality table." See also section 205(g)(3) of ERISA. PPA 2006 amended section 417(e)(3) of the Code to change the applicable interest rate and the applicable mortality table for plan years beginning on or after January 1, 2008.

Technical Update 07-3 provides guidance on the application of the PPA 2006 changes to calculation of minimum lump sum amounts in the case of a plan that terminated before the effective date of the changes but distributed plan assets on or after that effective date. Technical Update 07-3 did not address how the PPA 2006 changes apply to a plan that terminates after the effective date of the changes and makes a distribution in a plan year subsequent to the plan year the plan terminated (*e.g.*, a plan that terminates in its 2008 plan year, and pays lump sums in its 2009 plan year). This Technical Update provides that further guidance.

II. Minimum Lump Sum Assumptions

Applicable interest rate

Treasury regulations require a plan to specify a "lookback month" (determines which month's rate is used) and a "stability period" (determines the period for which that rate remains constant). For example, a plan with a calendar year stability period and a one-month lookback would use the applicable rate for December 2008 to determine minimum lump sums with distribution dates in 2009.

PPA 2006 changed the applicable interest rate under Code section 417(e)(3) to the adjusted first, second, and third segment rates derived from a corporate bond yield curve, similar to the rates used to determine minimum funding requirements under PPA 2006. Prior to the PPA 2006 changes, the applicable interest rate was the annual yield on 30-year Treasury securities. PPA 2006 provides a phase-in for the change to the new applicable interest rate over five years. Specifically, for plan years beginning in 2008 through 2011, the applicable segment rates are the adjusted segment rates determined in accordance with an applicable percentage. The segment rates are thus blended with 30-year Treasury yields to develop transitional segment rates, using a 20 percent weighting of the new PPA 2006 rates for the plan year beginning in 2008, 40 percent for 2009, 60 percent for 2010, and 80 percent for 2011. Starting with plan years beginning in 2012, the new segment rates are fully phased in.

The IRS publishes both the section 417(e) segment rates and the transitional segment rates monthly (*e.g.*, Notice 2008-75 provides minimum present value transitional segment rates determined for August 2008).

Applicable mortality table

For plan years beginning on or after January 1, 2008, the applicable mortality table under Code section 417(e)(3) is the table required for the plan year by the Secretary of the Treasury for minimum funding purposes under PPA 2006, modified as appropriate (*e.g.*, to reflect unisex mortality), based on the actual experience of pension plans and projected trends. IRS Revenue Ruling 2007-67 provides guidance on adjusting the mortality table under section 430(h)(3) of the Code for purposes of Code section 417(e) and provides the adjusted applicable mortality table for annuity starting dates in 2008.

PPA 2006 does not provide a phase-in for the change to the new applicable mortality table.

III. Plan Sufficiency and Close-out of Plan in a Standard Termination

Under section 4041(b) of ERISA, a plan may terminate in a standard termination and proceed with a final distribution "only if . . . when the final distribution of assets occurs, the plan is sufficient for benefit liabilities (determined as of the termination date)." Section 4041.8(a) of PBGC's regulation on Termination of Single-Employer Plans states that a "participant's or beneficiary's plan benefits are determined under the plan's provisions in effect on the plan's termination date," with limited exceptions (see note 4 in Technical Update 07-3).
Section 4041.28(c)(2) of PBGC's termination regulation provides that, in the absence of evidence establishing that another date is the annuity starting date under the Code, the distribution date is the annuity starting date for purposes of calculating the present value of plan benefits (*e.g.*, in determining which interest rate is used to value a lump sum distribution). For example, consider a calendar year plan with a two-month lookback and a one-year stability period. If this plan has a termination date in 2012 and makes final lump sum distributions in 2013, the applicable interest rate(s) are the 417(e) segment rates for November 2012 [2] .

IV. Impact of PPA 2006 on 417(e) Changes on Plans that Terminate on or After Effective Date of Changes

Questions have been raised about how the PPA 2006 changes to Code section 417(e) apply in the case of a plan that terminates in a plan year after the PPA 2006 effective date, but pays lump sums in a subsequent plan year.

General

As explained in Technical Update 07-3, the minimum lump sum value of a participant's accrued benefit is calculated using the definition of "applicable interest rate" and "applicable mortality table" based on the plan provisions reflecting the law in effect on the plan's termination date, but the time for determining the specific assumptions is based on the distribution date.

Applicable interest rate

The PPA 2006 amendments to section 417(e)(3), including the applicable phase-in percentages for years 2008 through 2011, apply to plan years beginning after December 31, 2007. PBGC therefore believes it should treat the applicable phase-in percentages as part of the PPA 2006 change in assumptions. It follows that for a plan that terminates in 2008 through 2011, the applicable interest rate is determined based on the applicable phase-in percentage in effect for the plan year in which the lump sum is paid (not for the plan year in which the plan terminates). Accordingly, if a plan's termination date occurs during the phase-in period, the specific interest rates used to calculate the minimum value of a lump sum payment (determined in accordance with the stability period and lookback month in effect on the termination date) reflect the weighting of the 30-year Treasury yields and the new PPA rates under Code section 417(e)(3)(D) on the distribution date.

For example, assume a calendar year plan is amended in 2008 to reflect PPA 2006 minimum lump sum assumptions and terminates on July 1, 2009. Also assume that the plan has a one-year stability period and a two-month lookback. Therefore, a lump sum paid in 2010 is calculated based on the phase-in percentage for the plan year beginning in 2010 and the November 2009 rates. Accordingly, a lump sum paid in 2010 would be determined using a blended rate based on a 60 percent weighting of the November 2009 segment rates and a 40 percent weighting of the November 2009 30-year Treasury rate.

Applicable mortality table

Annual updates to the applicable mortality table are part of the base mortality table prescribed by the Secretary of Treasury under section 430(h)(3) of the Code, which is projected to improve using specified factors. Because the annual updates are part of the base mortality table, they are included in the law in effect on the termination date. Accordingly, for a plan with a termination date on or after the first day of the first plan year beginning in 2008, a lump sum would be determined based on the applicable mortality table as specified by the Secretary of Treasury on the plan's termination date, taking into account projected mortality improvements under the table through the plan year containing the distribution date.

Lump sums provided under annuity contract

The guidance above also applies to the calculation of minimum lump sum amounts in the case of a plan with a termination date on or after the first day of the first plan year beginning in 2008, which provides plan benefits through the purchase of an annuity contract that provides for payment of lump sums in the future.

V. Disclaimer

This guidance represents PBGC's current thinking on this topic. It does not create or confer any rights for or on any person or operate to bind the public. If an alternative approach satisfies the requirements of the applicable statutes and regulations, you can use that approach. If you want to discuss an alternative approach (you are not required to do so), you may contact the PBGC.

VI. PBGC Contact Points

For questions about this Technical Update 08-4, contact Constance Markakis of the Legislative and Regulatory Department at (202) 326-4223, ext. 6779, or markakis.constance@pbgc.gov, or Amy Viener of the Policy, Research and Analysis Department at (202) 326-4000, ext. 3919, or viener.amy@pbgc.gov.

1- This Technical Update also applies to distress terminations where the plan closes out under 29 CFR § 4041.50.

2- For convenience, this Technical Update assumes that the distribution date is the annuity starting date.