Technical Update 07-3: Minimum Lump Sum Assumptions for Terminating Single-Employer Plans; Effect of Pension Protection Act of 2006

December 03, 2007

This Technical Update 07-3 provides guidance on lump sum valuation issues for single-employer plans that terminate in a standard termination pursuant to ERISA section 4041, 1 with a termination date prior to, and a final distribution date on or after, the effective date of changes in the interest rate and mortality table used in calculating minimum lump sum values under the Pension Protection Act of 2006 ("PPA 2006"). It also provides limited guidance for single-employer plans that terminate on or after the effective date of the PPA 2006 changes.

I. Minimum Lump Sum Assumptions

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.

For plan years beginning after the effective date of the Retirement Protection Act of 1994, and before January 1, 2008, the "applicable interest rate" is the annual interest rate on 30-year Treasury securities. 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 30-year Treasury rate for December 2006 to determine minimum lump sums with distribution dates in 2007. The "applicable mortality table" is prescribed by the Secretary of the Treasury and updated periodically.

For plan years beginning on or after January 1, 2008, PPA 2006 amended section 417(e)(3) of the Code to change the applicable interest rate and the applicable mortality table. 2 Under this amendment, the applicable interest rate means three segment rates derived from a corporate bond yield curve, similar to the rates used to determine minimum funding requirements under PPA 2006. For plan years beginning in 2008 through 2011, the segment rates are blended with 30-year Treasury yields to develop Transitional Segment Rates. The IRS publishes applicable interest rates monthly. See, for example, IRS Notice 2007-81, which includes the Transitional Segment Rates for August 2007.

The applicable mortality table is the table required 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.

Because the applicable mortality table reflects projected trends, the IRS will publish updated tables in future guidance. IRS Revenue Ruling 2007-67 sets forth the 2008 mortality table. In general, the mortality table in the Ruling applies to distributions with annuity starting dates that occur during stability periods that begin during calendar 2008, on or after the first day of the first plan year beginning in 2008.

II. 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 the 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."

Section 4041.28(c)(2) 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 plan with a one-month lookback and a one-month stability period. If this plan has a termination date in 2006 and makes final distributions in February 2007, the applicable interest rate is the annual rate on 30-year Treasury securities for January 2007.

III. Impact of PPA 2006 §417(e) Changes on Plans that Terminate Before Effective Date of Changes

PPA 2006 changes the definition of the applicable interest rate and applicable mortality table under Code section 417(e)(3), raising the question of which definition applies if the plan's termination date occurs in a plan year beginning before the effective date of the change and the final distribution date is a date on or after the effective date of the change.

PBGC regulations clearly distinguish between, on the one hand, the plan provisions in effect as of the termination date that prescribe the basis or methodology for determining the section 417(e) interest rate and mortality assumptions, and, on the other hand, the specific assumptions, based on the distribution date, that are called for by those plan provisions. Accordingly, 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. 3

Furthermore, because the PPA 2006 amendments to the applicable interest rate and the applicable mortality table under section 417(e)(3) of the Code are effective only for plan years beginning in and after 2008, plan provisions incorporating those requirements cannot take effect for purposes of ERISA section 4041 before the first plan year beginning on or after January 1, 2008. Therefore, such plan provisions (regardless of whether they were added to the plan before, or on or after, the plan's termination date 4) are not effective for a plan with a termination date before the beginning of its 2008 plan year, even if the distribution date is after the 2007 plan year.

For example, assume a calendar year plan has a termination date of July 1, 2007, and makes the PPA 2006 amendments described above on June 30, 2007. Also assume that the plan has a one-month lookback and a one-month stability period. Because the plan terminated before PPA 2006 took effect, pre-PPA 2006 law (applicable interest and applicable mortality) applies. If the plan makes its final distribution of assets in February 2008, the applicable interest rate would be the 30-year Treasury rate for January 2008 (the month before the distribution date) and the applicable mortality table would be that in effect on July 1, 2007 (*i.e.*, the table provided in IRS Rev. Rul. 2001-62). The same would be true if the plan had not been amended but provided that section 417(e)(3) was incorporated by reference, without a specific description of the applicable actuarial assumptions.

This Technical Update does not address the assumptions that apply where a plan has a termination date in one plan year after the effective date of the PPA 2006 lump sum assumptions and makes distributions in a subsequent plan year; *i.e.*, whether the applicable interest rate percentage (the phase-in) and the applicable mortality table used in determining minimum lump sums are those in effect on the plan's termination date or those in effect on the distribution date. PBGC intends to issue future guidance on these issues.

IV. 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.

V. PBGC Contact Points

For questions about this Technical Update 07-3, 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 of plans that are sufficient for guaranteed benefits or benefit liabilities and that close out under section 4041.50 of PBGC's regulations.

2 PPA 2006 provides that, in general, a plan amendment to implement these changes to the minimum value requirements may apply to benefits already accrued, without violating the anti-cutback rules under section 411(d)(6) of the Code.

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

4 Section 4041.8 of PBGC's regulations provides that an amendment that is adopted after the plan's termination date is taken into account to the extent the amendment does not decrease the value of the participant's or beneficiary's benefit under the plan's provisions in effect on the termination date. However, in the case of a plan that has a termination date in the 2007 plan year, PBGC will not take into account an amendment adopted after the plan's termination date that substitutes the PPA 2006 assumptions for the pre-PPA 2006 assumptions, even if the amendment increases benefits for some participants.