

Part IV. Items of General Interest

Automatic Approval of Changes in Funding Method for Takeover Plans and Changes in Pension Valuation Software

Announcement 2010-3

This announcement provides, for plan years beginning on or after January 1, 2009, automatic approval for certain changes in funding method with respect to single-employer defined benefit plans that result either from a change in the valuation software used to determine the liabilities for such plans or from a change in the enrolled actuary and the business organization providing actuarial services to the plan. This guidance is being provided in response to numerous requests from actuaries and plan sponsors, many of whom are continuing to modify their valuation software in order to implement the changes to the funding rules made by the Pension Protection Act of 2006 (PPA '06), the Worker, Retiree, and Employer Recovery Act of 2008 (WRERA '08), and guidance regarding these legislative changes.

Background

A change in funding method can occur when the business organization providing actuarial services to a plan modifies its valuation software. A change in funding method can also occur when the enrolled actuary and business organization providing actuarial services for a plan is changed and the new enrolled actuary uses different valuation software than the prior enrolled actuary, or otherwise applies the overall funding method in a different manner (plans for which both the enrolled actuary and the business organization providing actuarial services are changed are referred to as “takeover plans”).

Under § 412(c)(5) of the Code (and its counterpart in section 302(c)(5) of ERISA) as in effect prior to PPA '06, any change of funding method required the approval of the Secretary. Revenue Procedure 2000-40, 2000-2 CB 357, provided automatic approval for certain changes in funding method resulting from changes in valuation software (section 4.04) and for changes in funding method that occurred with respect to takeover plans (section 4.03). With respect to changes in funding method resulting from changes in valuation software, Revenue Procedure 2000-40 provided approval for the changes if: (1) net charges to the funding standard account determined using the new valuation software did not differ by more than 2% from the net charges determined using the old valuation software (the “pre-PPA 2% test”); (2) the modification to the computations in the valuation software or the use of a different valuation software system were designed to produce results that were no less accurate than the results produced prior to the modification or change; and (3) the approval for takeover plans described in the next paragraph was not applicable.

With respect to takeover plans, Revenue Procedure 2000-40 provided approval for changes in funding method if: (1) there was both a change in the enrolled actuary for the plan and a change in the business organization providing actuarial services to the plan; and (2) the method used by the new actuary was applied to the prior plan year and that the absolute value of each resulting difference in normal cost, accrued liability (if directly computed under the method), and actuarial value of assets, that was attributable to the change in method did not exceed 5% of the respective amounts calculated by the prior actuary for that prior year (the "pre-PPA 5% test").

PPA '06 Funding Rules

Section 412 of the Code and section 302 of ERISA, as amended by PPA '06, retain the requirement that a change in funding method be approved by the Secretary. Under PPA '06, a single funding method must be used for any single-employer defined benefit plan, but there may be some variation in the manner the method is applied. Final regulations were issued under § 430 on October 15, 2009, 74 FR 53004, (the "October 2009 regulations") and are generally effective for plan years beginning on or after January 1, 2010. Under § 1.430(d)-1(f)(1)(iv) of the October 2009 regulations, a plan's funding method includes not only the overall funding method used by the plan, but also each specific method of computation used in applying the overall method. Accordingly, a change in valuation software can result in a change in funding method that requires the approval of the Secretary.

The October 2009 regulations provide approval for a number of changes in funding method and for changes in the interest rate. For the first plan year beginning on or after January 1, 2008, any changes in funding method that are not inconsistent with the requirements of § 430 are treated as having been approved by the Commissioner and do not require specific prior approval. For plan years beginning in 2009 and 2010, certain changes in funding method (concerning the methodology of allocating liabilities to years, the selection of the valuation date, and the selection of the asset valuation method) and in the selection of interest rates are also approved. Section 1.430(d)-1(g)(3) provides general approval for a change in funding method (which would include a change in funding method resulting from a change in valuation software) for the first plan year beginning on or after January 1, 2010. However, if certain sections of the regulations were applied to a plan for a plan year beginning on or after January 1, 2009, but before January 1, 2010, approval is provided with respect to such a plan for a change in funding method (including a change in funding method resulting from a change in valuation software) for that plan year, in lieu of the general approval for changes for the first plan year beginning on or after January 1, 2010.

Even though approval was provided for certain changes for the 2009 and 2010 plan years, actuaries and plan sponsors have expressed concern that changes in

valuation software may encompass changes in funding method for which the October 2009 regulations do not provide automatic approval. Furthermore, forthcoming regulations under § 430 may result in additional changes in valuation software.

Revenue Procedure 2000-40 has not been updated to reflect the changes made by PPA '06. Moreover, the calculations that were used for the pre-PPA 2% test and the pre-PPA 5% test are not used under § 430 of the Code and section 303 of ERISA.

Automatic Approval for Takeover Plans and Valuation Software Changes

For plan years beginning on or after January 1, 2009, automatic approval is provided for any change in funding method under § 430 if the following conditions are satisfied:

- (1) There has been a change both in the enrolled actuary for the plan and in the business organization providing actuarial services to the plan;
- (2) The new method is substantially the same as the method used by the prior enrolled actuary and is consistent with the description of the method contained in the prior actuarial valuation report or prior Schedule SB of Form 5500;
- (3) The funding target and target normal cost (without regard to any adjustments for employee contributions and plan-related expenses), as determined for the prior plan year by the new enrolled actuary (using the actuarial assumptions of the prior enrolled actuary), are both within 5% of those values as determined by the prior enrolled actuary; and
- (4) For plan years beginning on or after January 1, 2011, the actuarial value of plan assets, as determined for the prior plan year by the new enrolled actuary (using the actuarial assumptions of the prior enrolled actuary), is within 5% of the value as determined by the prior enrolled actuary.

Conditions (2), (3), and (4) are each applied by disregarding any change in funding method for which approval has been automatically provided (without regard to this announcement) for the current plan year. For example, automatic approval is provided under § 1.430(d)-1(g)(3)(ii)(C) for changes in the allocation of liabilities that are necessary to apply the rules of § 1.430(d)-1(c)(1)(iii) for a plan year beginning before January 1, 2010. Thus, if such a change in funding method is made for a takeover plan for the 2009 plan year, the 5% test of condition (3) with respect to the prior plan year (2008) is determined using the allocation of liabilities used by the prior enrolled actuary.

For plan years beginning on or after January 1, 2009, automatic approval is provided for any change in funding method under § 430 resulting from a change in valuation software if the following conditions are satisfied:

- (1) There has not been both a change in the enrolled actuary for the plan and a change in the business organization providing actuarial services to the plan;
- (2) Except to the extent automatic approval has been provided for a change in funding method without regard to this announcement, the underlying method is unchanged and is consistent with the information contained in the prior actuarial valuation report and prior Schedule SB of Form 5500;
- (3) The new valuation software is generally used by the enrolled actuary for the single-employer plans to which the enrolled actuary provides actuarial services;
- (4) The funding target and target normal cost (without regard to any adjustments for employee contributions and plan-related expenses) under the new valuation software (for either the current plan year or the prior plan year) are each within 2% of the respective values under the prior valuation software (all other factors being held constant);
- (5) For plan years beginning on or after January 1, 2011, the actuarial value of assets for the plan under the new valuation software (for either the current plan year or the prior plan year) is within 2% of the value under the prior valuation software (all other factors being held constant); and
- (6) The modifications to the computations in the valuation software or the use of a different valuation software system are designed to produce results that are no less accurate than the results produced prior to the modifications or change.

The automatic approval provided by this announcement will apply until it is superseded by future guidance.

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