



AMERICAN BENEFITS COUNCIL

September 12, 2012

SUMMARY AND ANALYSIS OF IRS NOTICE 2012-61, DEFINED BENEFIT PENSION PLAN FUNDING STABILIZATION GUIDANCE UNDER MAP-21

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On September 11, the Internal Revenue Service (IRS) issued [Notice 2012-61](#), guidance on the special rules applicable to single-employer defined benefit pension plans under the funding stabilization legislation in the [Moving Ahead for Progress in the 21st Century \(MAP-21\) Act \(H.R. 4348\)](#), enacted on July 6. This guidance, covering matters such as benefit restriction and transition issues, is provided in question-and-answer format.

Plan sponsors (with calendar year plans) have until *September 15, 2012*, to make contributions for 2011. Contributions for 2011 can result in benefit restrictions being lifted for the remainder of 2012 and can also affect the applicability of credit balances (now called pre-funding balances and funding standard carryover balances) and benefit restriction presumptions for 2013. Under the guidance, plan sponsors may also take other actions to reverse certain decisions made earlier in 2012.

Set forth below is a summary of certain key aspects of the funding and PBGC guidance ([Technical Update 12-2](#)) that are of the most interest to plan sponsors. The summary below is not intended to be comprehensive, but rather is intended to highlight key points.

- 1. Lump sum valuation for funding purposes.** The guidance expressly confirms that the current law rules apply in valuing lump sums for funding purposes. In general, that means that the value of a lump sum is determined by valuing the annuity on which the lump sum is based. The annuity is, of course, valued using the stabilized interest rates. This is the very beneficial result that, in our view,

Congress intended, since it ensures that all plans will benefit from funding stabilization, not just half the plans. This has been the Council's lead issue in the discussions with the IRS and Treasury.

2. **Broad applicability of the stabilized segment rates.** The guidance confirm that the new stabilized segment rates apply in all cases where there is a direct or indirect reference to segment rates, except to the extent that the legislation specifically states that the stabilized rates do not apply. So, for example, the stabilized rates apply for purposes of (a) the asset averaging rules, (b) application of the special rules for eligible cooperative plans and eligible charity plans, and (3) the determination of shortfall amortization bases and installments. Again, in our view, this is consistent with Congress' very beneficial intent.
3. **Hybrid plan issues.** Interestingly, this guidance announces for the first time that the hybrid plan regulations proposed in October of 2010 (dealing with the market rate of return rule and other hybrid plan issues) will not be effective for plan years beginning before January 1, 2014. This is a positive development that had not been announced either formally or informally before the issuance of this guidance.
 - a. **Plans that currently use a segment rate as their interest crediting rate.** Guidance was needed on hybrid plans that currently use the third segment rate (or the first or second segment rates) as their interest crediting rate. The concern was that the plan could arguably be compelled to credit interest at the new higher stabilized rate, perhaps retroactive to the beginning of the 2012 plan year. The guidance addresses this issue in two ways. First, the guidance states that prior to the effective date of the proposed hybrid plan regulations, "a plan administrator's reasonable interpretation of plan terms that provide for interest credits by reference to one of the . . . segment rates could reflect" that the plan's interest crediting rate is based on either a stabilized or unstabilized segment rate. Second, if the plan administrator's reasonable interpretation is that the plan's crediting rate is based on the unstabilized segment rate, that can be clarified in a timely plan amendment without raising a problem under the anti-cutback rules and without triggering a requirement to provide a 204(h) notice regarding a reduction in future accruals.
 - b. **Stabilized segment rates as market rates.** The guidance does not provide any certainty as to whether the final hybrid plan regulations will permit the use of the stabilized segment rates as market rates of return. But if the regulations do not permit such rates, the guidance states that the generally applicable transition rules will apply to plans that are using stabilized rates.

4. Transition issues.

- a. **Permitted reversal of credit balance reductions.** In many cases, earlier in 2012, plan sponsors reduced their “credit balances”, either voluntarily or mandatorily, to avoid the application of benefit restrictions. (For convenience of presentation, this summary uses the term “credit balances” to refer to funding standard carryover balances and prefunding balances.) In light of the new stabilized segment rates, many of those reductions were unnecessary and it would be advantageous to reverse those elections to preserve credit balances. In general, under the guidance, plan sponsors may elect to reverse such credit balance reductions, subject to a deadline of the last day of the 2012 plan year (and subject to certain other limited exceptions.) The current regulations will be modified to reflect this new rule; in the meantime, plan sponsors can rely on the guidance.
- b. **Impermissible reversal of credit balance usage.** Prior elections to use a credit balance to offset a 2012 required contribution cannot be reversed under the guidance, except as otherwise already permitted under current law.
- c. **Permitted use of prior 436 contributions to satisfy minimum funding obligations.** In many cases, earlier in 2012, plan sponsors made special “436 contributions” to the plan to avoid the application of benefit restrictions; 436 contributions can serve to eliminate a benefit restriction but cannot be counted toward satisfying a plan sponsor’s minimum funding obligation. In light of the new stabilized segment rates, many of those contributions were not needed to avoid benefit restrictions, and it would be advantageous to apply the contributions toward meeting the plan sponsor’s minimum funding obligations. In general, under the guidance, 436 contributions will be applied against the plan sponsor’s minimum funding obligation to the extent that the contribution is not needed to avoid a benefit restriction. The current regulations will be modified to reflect this new rule; in the meantime, plan sponsors can rely on the guidance.
- d. **Contributions for 2011 re-designated as 2012 contributions.** In some cases, a plan sponsor may have made an excess contribution for 2011 to, for example, avoid a benefit restriction for 2012. In light of the new stabilized segment rates, many of such excess contributions may not have been needed to avoid a benefit restriction. Because of this type of situation, the guidance states that “despite the general position of the Service that a contribution designated for a particular plan year cannot be re-designated to apply for another plan year after the Schedule SB is filed,

the plan sponsor may” under certain circumstances re-designate all or part of a 2011 plan year contribution as a 2012 plan year contribution.

- e. **Updated certifications to avoid benefit restrictions.** In many cases, (1) a plan has applied benefit restrictions for 2012 based on an earlier certification that the benefit restrictions had to apply, and (2) those benefit restrictions would not have applied if the new stabilized rates had been used. The guidance gives plan sponsors the option of applying an updated certification reflecting the stabilized rates either prospectively or retroactively. The guidance provides detail on how a retroactive application would work where prior operations were inconsistent with the updated certification. The guidance permits prospective application of the updated certification so that the benefit restrictions can be lifted prospectively (as of the earlier of October 1, 2012 or the date of the updated certification) and no retroactive corrections are needed. (The current regulations will be modified to reflect this new rule; in the meantime, plan sponsors can rely on the guidance.) In order to use this rule, the updated certification must be completed as soon as practicable; a recertification after December 31, 2012 will not be treated as meeting this requirement.
5. **Simplifications.** The new stabilized segment rates do not apply for various purposes, including, for example, the deduction limits applicable to company contributions to a plan and the determination regarding whether a plan sponsor must report actuarial and financial information to the PBGC under ERISA Section 4010.
- a. **Deduction issue.** In applying the deduction limits, it is necessary to calculate the value of plan assets. Technically, the valuation of plan assets can be affected by the segment rates, which would result in a separate calculation of plan assets for funding purposes as opposed to deduction purposes. Generally, the guidance requires such separate calculations. However, the guidance permits plan sponsors to use the funding calculation of asset value for deduction purposes, albeit only in situations where the stabilized third segment rate is higher than the unstabilized third segment rate, as is currently the case.
 - b. **4010 reporting.** As noted, the PBGC issued separate guidance under ERISA Section 4010 (Technical Update 12-2). That guidance generally states that the value of plan assets used for funding purposes can also be used for determining if a plan has to report under Section 4010. In addition, the guidance permits the use of funding calculations for a variety of reporting purposes and for purposes of applying the exception

from reporting for aggregate funding shortfalls of no more than \$15 million. These are all helpful clarifications.

- 6. Elections.** The guidance provides details as to how to make the various elections permitted under the legislation and under the guidance itself.