

## SHDR Actuarial Services - Pension



### PENSION FUNDING RELIEF

Plan funding rules changed substantially in 2008 as a result of the passage of the Pension Protection Act of 2006 (PPA). On December 23, President Bush signed H.R. 7327, the "Worker, Retiree, and Employer Recovery Act of 2008," WRERA, which moderates minimum contributions, delays required minimum distributions (*i.e.* age 70½ distributions) from certain retirement accounts for one year, provides technical corrections and makes other miscellaneous changes to tax and pension laws.

This new law will reduce the contribution requirements for some of our clients for 2008, 2009 and 2010. The law also allows for the use of a smoothed asset value, called the Expected Value of Assets (EVA), which many of you may want to adopt. Using smoothed asset values provides for a higher "funded ratio" and lower minimum contributions when assets values are down. In an increasing market it can delay the effect of cost reductions resulting from higher than expected returns. Using an EVA delays the full impact of a gain or loss for three years. In a down market, it spreads costs out over nine years, instead of seven. An EVA may provide some relief by giving a plan sponsor extra time to spread the cost of recent asset losses over a few more years.

#### Summary of Key Points

##### Funding Target Transition

Under PPA, the minimum contribution is the sum of the Target Normal Cost (TNC) and a 7-year amortization of the excess, if any, of unfunded Target Liability (TL). For 2008, unfunded Target liability will be based on 92% of TL, increasing to 94% for 2009, 96% for 2010 and then 100% for 2011, if certain conditions are met. *The net effect is minimum contribution will likely be less for plan years before 2011.*

##### Asset Smoothing – Expected Value of Assets

Expected return on plan assets can now be used in determining the actuarial value of assets. The assumed rate of return cannot exceed a benchmark of the appropriate 3<sup>rd</sup> segment rate used for valuing certain PPA liabilities. While this is an improvement, the resulting value has a 10% collar on it and must be within 10% of the market value of assets.

##### Restrictions on Benefit Accruals – Less Than 60% Funded Ratio

For plan years beginning from October 1, 2008 through September 30, 2009 only, the funded ratio used to determine a plan freeze in 2009 will be based on either the 2008 or 2009 funded ratio. If either ratio is over 60% no restrictions will be applied for that plan year. Thereafter, restrictions will be based on the actual funded ratio at the beginning of the year, without comparison to an earlier year.

##### De Minimis Lump Sums

Mandatory lump sums below \$5,000 (\$1,000 if your plan elected the lower mandatory limit) can now be paid even if the benefit restrictions apply.

##### Provision for Plan Expenses

If expenses are paid by the plan trust, the TNC must be increased, no later than 2009, by the expected expenses. This would likely result in an increase to the minimum contribution.

Some of the provisions above require regulations to be issued before they take effect, and the details are unclear until regulations are issued.

## Retirement Plan for Employees of the Sample Company

### 2008 Illustrative Results

The following illustrates the 2008 results and what the results would have been if the actuarial value of assets (AVA) was 10% more than the market value of assets (MV). This is simply an illustration of the impact of the asset valuation change. In all likelihood, the AVA at the 2008 valuation date would be within 10% of MV.

	Original Valuation	Illustrative Valuation
Effective Interest Rate	6.11%	6.11%
Target Liability	6,265,000	6,265,000
Actuarial Value of Assets	5,030,000	5,533,000
Credit Balance	18,400	128,000
Funded Percentage	80.3%	88.3%
Funding Target Attainment Percentage	80.0%	86.3%
<b>Contribution Before Credit Balance</b>		
- Target Normal Cost	148,000	148,000
- Unfunded Target Liability	1,253,000	860,000
- Funding Shortfall	1,253,000	359,000
- 7 Year Funding Shortfall Amortization	212,000	66,000
<b>Minimum Contribution (Estimated)</b>		
- Minimum Contribution Before Credit Balance	382,000	227,000
- Credit Balance	20,000	136,000
- Minimum Contribution at year end	362,000	91,000

The illustrative valuation results are likely to be more favorable than expected for 2008. However, the impact on the 2009 valuation results will be more inline with the figures represented by the illustrative valuation.

We are available to review these alternatives and help develop an optimal set of assumptions and methods for your plan.

We are not engaged in the practice of law, and the foregoing is not intended as legal advice nor is it intended to replace any legal opinion from counsel. We recommend that you consult with your attorney or tax advisor regarding any issues contained herein. The foregoing is not intended or written to be used, and cannot be used, for the purpose of avoiding tax-related penalties.