Additional Funding Rules for Multiemployer Plans in Endangered or Critical Status (IRC section 432)

- A plan is in critical status if one or more of the following conditions exist as of the first day of the plan year.
  - The funded percentage (ratio of actuarial value of assets to unit credit accrued liability) of the plan is less than 65% and the sum of the market value of the assets and the present value of the expected contributions for the current year and the next six years (for a total of 7 years) is less than the present value of the expected future non-forfeitable benefits projected to be payable in the current year and the next six years.
  - The plan has a funding deficiency for the current year, or is projected to have a deficiency for any of the next 3 years (4 years if the funded percentage is 65% or less). Extension of amortization periods are ignored for this purpose.
  - Each of the following 3 conditions is satisfied.
    - The current year normal cost plus valuation interest for the current year on the unfunded benefit liabilities as of the last day of the prior year exceeds the present value of the expected employer and employee contributions for the current year.
    - The present value as of the beginning of the current year of the non-forfeitable benefits of the inactive participants exceeds the present value of the non-forfeitable benefits of the active participants.
    - The plan has a funding deficiency for the current year, or is projected to have a deficiency for any of the next 4 years. Extension of amortization periods are ignored for this purpose.
  - The sum of the market value of assets and the present value of expected future employer contributions for the current year and each of the next four years is less than the present value of benefits expected to be paid during the current year and each of the next four years.

- A plan is in critical and declining status if both of the following conditions apply.
    - The plan satisfies at least one of the four conditions to be in critical status.
    - The plan is projected to become insolvent in the current year or any of the next 14 years (19 years if the ratio of inactive participants to active participants exceeds 2:1, or if the plan's funded percentage is less than 80%).
- A plan is in endangered status if it is not in critical status and one of the following conditions exists as of the first day of the plan year. If both conditions are satisfied, then the plan is considered to be seriously endangered.
    - The funded percentage (ratio of actuarial value of assets to unit credit accrued liability) of the plan is less than 80%.
    - The plan has a funding deficiency for the current year, or is projected to have a deficiency for any of the next 6 years. Extension of amortization periods are taken into account for this purpose.
- A plan sponsor of a plan that is in endangered status must adopt a funding improvement plan and must follow certain rules of operation.
- A plan sponsor of a plan that is in critical status must adopt a rehabilitation plan and must follow certain rules of operation.
- Certification by the plan actuary
    - The actuary must certify no later than 90 days after the beginning of the plan year whether the plan will either be in endangered status, critical status, or critical and declining status.
    - The actuary must also certify whether or not the plan is making the scheduled progress for plans that have adopted either a funding improvement or rehabilitation plan.
    - Notice must be made by the plan sponsor to the participants and beneficiaries of the plan, the bargaining parties, the PBGC and the Secretary of Labor within 30 days of certification by the actuary of the status of the plan.

- Funding improvement plan
  - Must be adopted within 240 days after the actuarial certification that the plan is in endangered status.
  - Funding improvement plan is designed to increase the funded percentage of the plan as of the end of the funding improvement period by at least ⅓ of the difference between 100% and the funded percentage before the funding improvement. For a seriously endangered plan, 1/5 is substituted for ⅓.
  - The funding improvement period is generally equal to the 10-year period (15-year period for a seriously endangered plan) beginning on the first day of the plan year after the second anniversary of the adoption of the funding improvement plan. However, if the collective bargaining agreement in effect at the time of the actuarial certification of endangered status expires before the second anniversary, then the 10-year (or 15-year) period begins on the first day of the plan year following the expiration of the collective bargaining agreement. This last condition only applies if at least 75% of the active participants in the multiemployer plan were covered by the expiring collective bargaining agreement.
  - The funding improvement adoption period is the time between the certification of the plan's endangered status and the time when the funding improvement period begins.
  - Restrictions on plan during improvement period and adoption period
    - The level of contributions cannot be reduced for any plan participant.
    - Contributions cannot be suspended for any period of service.
    - Plan cannot be amended to exclude new participants beyond the restrictions at the time of the certification of the plan's endangered status.
    - Generally, no plan amendment can increase liabilities unless required by law. There is an exception if the actuary certifies that the increase will be paid from additional contributions not otherwise required by the funding improvement plan.

- Rehabilitation plan
  - Must be adopted within 240 days after the actuarial certification that the plan is in critical status.
  - Rehabilitation plan is designed to allow the plan to cease to be in critical status as of the end of the rehabilitation period. This can be accomplished through decreases in plan expenditures, decreases in future benefit accruals, or increases in future contributions.
  - The rehabilitation period is generally equal to the 10-year period beginning on the first day of the plan year after the second anniversary of the adoption of the rehabilitation plan. However, if the collective bargaining agreement in effect at the time of the actuarial certification of critical status expires before the second anniversary, then the 10-year period begins on the first day of the plan year following the expiration of the collective bargaining agreement. This last condition only applies if at least 75% of the active participants in the multiemployer plan were covered by the expiring collective bargaining agreement.
  - The rehabilitation plan adoption period is the time between the certification of the plan's critical status and the time when the rehabilitation period begins.
  - There is a surcharge on employer contributions during the rehabilitation period.
    - The surcharge in the initial year that the plan is in critical status is equal to 5% of the otherwise required contribution from each employer.
    - The surcharge in subsequent years is equal to 10% of the otherwise required contribution from each employer.
    - The surcharge is no longer required for any employer covered by a renegotiated bargaining agreement that takes into account the increased requirements of the rehabilitation plan.
    - The surcharge cannot be used to provide for increased benefit accruals.
    - The surcharge is payable at the time that the minimum required contribution is paid.

- Restrictions on plan during rehabilitation period and adoption period
  - Generally, no plan amendment can increase liabilities unless required by law. There is an exception if the actuary certifies that the increase will be paid from additional contributions not otherwise required by the rehabilitation plan, and that this will not negatively impact the plan emerging from critical status on schedule.
  - Benefits cannot be paid in excess of a monthly single life annuity (including any social security supplement).
  - Payment cannot be made as a lump sum to purchase an annuity from an insurer.
  - There is an exception for lump sums paid under the involuntary cash-out rules of IRC section 411(a)(11).
  - Additional restrictions during the adoption period (after certification of critical status but before the first day of the rehabilitation period)
    - The level of contributions cannot be reduced for any plan participant.
    - Contributions cannot be suspended for any period of service.
    - Plan generally cannot be amended to exclude new participants beyond the restrictions at the time of the certification of the plan's critical status.
    - No plan amendment can increase liabilities unless required by law

- Additional rules for plans in critical and declining status
  - All of the rules that apply to a plan in critical status apply when the plan is in critical and declining status.
  - The plan sponsor can, at its option and with IRS approval, amend the plan to suspend benefits in a manner deemed appropriate by the plan sponsor. "Suspension of benefits" in this case is defined as a temporary or permanent reduction of any current or future payment obligation to any participant or beneficiary under the plan, regardless of whether they are currently in pay status. Note that this can reduce benefits already accrued.

- The suspension of benefits remains in effect until the earlier of the time that the plan provides benefit improvements or the expiration of the suspension of benefits, if it is a temporary suspension.
- Requirements for suspension of benefits
  - The plan actuary must certify that, taking into account the suspension, the plan is projected to avoid insolvency.
  - The plan sponsor makes a written determination that all other reasonable measures have been taken for the plan to avoid insolvency, and that without the suspension of benefits the plan is projected to become insolvent.
- Restrictions for suspension of benefits
  - Monthly benefits may not be reduced below 110% of the PBGC guaranteed benefit for any participant.
  - For participants at least age 75 on the date of the suspension of benefits, the benefit may not be <u>reduced</u> by more than the ratio of the number of months (from the date of suspension to age 80) to 60 months. Note that this would prevent any reduction for participants age 80 or older as of the date of suspension.
  - Disability benefits may not be reduced.
  - Suspended benefits must in the aggregate be reasonable to avoid insolvency
  - Suspended benefits must be equitably distributed across the participant and beneficiary population.
- There is a notice requirement to the plan participants which must be provided at the time that the plan sponsor makes the request to suspend benefits to the IRS.

Question 122

Type of Plan: Multiemployer

Actuarial Cost Method: Entry age normal (EAN)

Credit balance in funding standard account as of 12/31/2015: $20,000

Valuation interest rate: 7%

Valuation results as of 1/1/2016:

EAN accrued liability	$1,100,000
EAN normal cost	$50,000
Unit credit accrued liability	$900,000
Unit credit normal cost	$40,000
Actuarial (market) value of assets	$800,000

An extension of amortization periods has been granted under IRC section 431(d).

Amortization of bases as of 1/1/2016:

	With extension	Without extension
Charge bases	$30,000	$42,000
Credit bases	0	0

Contribution for 2016 deposited on 7/1/2016: $65,000

Consider the following statement:

The plan is in critical status under IRC section 432(b)(2) for 2016.

Is the above statement true or false?

Solution to Question 122

A plan is in critical status for a plan year if it satisfies one of four conditions under IRC section 432(b)(2). One of those conditions is that a plan is in critical status if it has a funding deficiency for the current year, ignoring any extension of amortization periods.

The minimum required contribution under the entry age normal cost method is equal to the normal cost, plus the amortization of any bases. These amounts are increased with interest to the end of the year, because the minimum is always determined as of the last day of the year.

Minimum required contribution (without regard to the extension of amortization period approval) as of 12/31/2016:

$$(\$50{,}000 + \$42{,}000) \times 1.07 = \$98{,}440$$

The minimum required contribution is reduced by the credit balance in the funding standard account as well as any contributions, each increased with interest to the last day of the year. If any required contribution remains after these reductions, then there is a funding deficiency.

2016 funding deficiency (without regard to the extension of amortization period approval) as of 12/31/2016:

$$\$98{,}440 - (\$20{,}000 \times 1.07) - (\$65{,}000 \times 1.07^{6/12}) = \$9{,}803$$

The plan is in critical status for 2016 because it would have a funding deficiency for 2016 (ignoring the extension of amortization period). The statement is true.

Note: The plan actually does not have a funding deficiency, because the contribution and credit balance were enough to cover the normal cost and amortization charges with regard to the approved extension of amortization period.