Note - Any federal tax advice contained in this transcript is intended to apply to the specific situation described and should not be considered official guidance independent of the presentation. The tax advice and statements contained herein should not be relied upon for retirement planning purposes without first consulting a tax or retirement planning professional. This transcript has been edited for technical accuracy and may differ slightly from the audio recording of the Defined Benefit Plan Update phone forum. This information is current as of April 23, 2013. Since changes may have occurred, no guarantees are made concerning the technical accuracy after that date.

Eddie: I would now like to formally begin today's teleconference and introduce John Schmidt.

John: Thank you Eddie and hello everyone. I am John Schmidt, the Staff Assistant from IRS Employee Plans Customer Education and Outreach and I'd like to thank you all for joining us today and I'd like to welcome you to our defined benefit plan update phone forum. Today we'll be hearing from Larry Heberle, Mike Spaid and Carol Zimmerman, all IRS actuaries with employee plans.

Before we start, I would like to point out a couple of things. If you have registered for this program and attend the entire live forum, you will receive a certificate of completion by e-mail in about one week. Enrolled agents, enrolled retirement plan agents and enrolled actuaries are entitled to continuing education credit for this session. Other types of tax professionals should consult their licensing organization to see if today's session qualifies for continuing education credit.

As with all of our presentations, the comments expressed by our speakers should not be construed as formal guidance from the IRS. We have an array of retirement plan resources available for you. For more information regarding defined benefit plans, please visit our retirement plans website at www.IRS.gov/retirement. You can also get there by going to the main www.IRS.gov landing page, clicking on the "Information for" dropdown box in the upper right-hand side of the screen and selecting "Retirement Plans," move to the left-hand navigation bar and select "Type of Retirement Plans" and click on "Defined Benefit Plans."

While you're visiting our website you might also want to subscribe to our free electronic newsletters. To subscribe, select the "Subscriptions" dropdown from the top of the screen, choose "More" and then select "Retirement News for Employers," which is our newsletter for employers sponsoring retirement plans or "Employee Plans News" for retirement plan professionals. Without further ado I'd like to turn this over to Larry.

Larry: Thank you John, and welcome everybody to our defined benefits plan update. On slide three, we have the agenda and the topics we're going to be covering today. We want to give you a brief regulatory update, we want to talk about some section 415 issues, Mike's going to cover some hybrid plan issues and we'll conclude with a brief look at some multiemployer reports that were recently issued to Congress.

First item that we want to look at is Notice 2012-46 and this begins on slide four. Under the pension protection act, PPA, Code section 436 was added. The goal of 436 is to preserve and improve funding for defined benefit plans. It's also a qualification issue under Code section 401(a)(29) so it's a pretty important section. And what 436 does is it restricts the plan benefits based on the AFTAP percentage.

Due to the time constraint today we're going to presume that most participants have a basic knowledge of some of the topics that we'll be covering today, including the AFTAP percentage. AFTAP stands for the Adjusted Funding Target Attainment Percentage and it's a measure of how well funded the plan is. We'll be referring to AFTAP a lot and hopefully you're familiar with that.

ERISA 101(j) requires a notice whenever these 436 benefit restrictions kick in. If the notice is not given there's a penalty. It's not an IRS penalty, but it's a Department of Labor penalty … $1,000 per day for failure to give the proper notice. It's a pretty important notice and we want to look at some of the parameters.

Moving on to slide five, the notice is required whenever the AFTAP, the plan's funded percentage, is below 60% and the plan provides unpredictable contingent event benefits, or what we UCEBs. If the plan's AFTAP is less than 60% or if the employer is operating under Chapter 11 bankruptcy, then the 436(d) restrictions apply to accelerated benefit payments and a notice under ERISA 101(j) will be required.

If the plan's AFTAP is above 60% but less than 80%, there's a partial restriction on these accelerated benefit distributions. Often times we think of those as lump sums but it applies to other things as well. If the plan's AFTAP, the funded percentage, is below 60% then the plan benefits are frozen. There are no more future accruals. 436(e) essentially shuts the plan down, freezes the plan, without any action on the part of the employer.

There's also 436(c) which restricts plan amendments, increasing benefits or increasing vesting. There's no 101(j) notice under 436(c) which makes sense because you wouldn't give a notice to tell the participants, "well we wanted to amend the plan to increase benefits but we're not allowed to because of the plan's AFTAP percentage," so there's no notice. There's no notice required under 436(c).

Moving on to the next slide, number 6, who is this notice required to be given to? Well it must be provided to each participant, each beneficiary, but only to those participants and beneficiaries that it's reasonably expected that the restriction will apply to.

For example, if you have a plan that provides UCEBs, or Unpredictable Contingent Event Benefits, but it provides them to plant A or location A but not to location B or plant B, the only employees that are reasonably expected to receive a UCEB benefit and therefore to be restricted under 436 would the employees of plant A and therefore they're the only ones that are required to get the 101(j) notice.

As another example, if you have retired annuitants and the restrictions under 436(d) will not allow the plan to make any lump sum payments. Well, retired annuitants will never receive a lump sum therefore they're not required to get the 101(j) notice if 436(d) applies. Or for example if you have vested terminees, people that are not actively accruing benefits under the plan and the AFTAP percentage falls below 60% and the plan is frozen, those vested terminees don't need to get the 101(j) notice because they're not currently accruing benefits. A notice informing them that their benefits accrual is frozen, this is of no use and is not required.

On slide seven, what is required to be in the notification that's given to participants and beneficiaries? Well, the plan name, the EIN, Employer ID Number, the plan number, a general description of the restriction on benefits that apply. Then you're required to notify the participant is this due to the presumed or certified AFTAP.

The general description is required to be given of the difference between restricted and unrestricted benefits. Prior to the restriction your benefit may have been "X"; after the restriction your benefit is "Y"; you're required to explain that. And what will happen if the restrictions cease to apply? If the AFTAP under the plan increases above 80% and all the 436 restrictions cease to apply.

On slide 8, more of what's required to be in the notice and the effective date of the benefit restrictions, the class of participants and beneficiaries that are affected by the restriction, name, address and phone numbers of the administrators and trustees or other contacts and special rules for new annuity starting dates.

For example, if you have a plan that allows for lump sums but then 436(d) restricts those lump sums because the plan's AFTAP percentage falls below 60%, you would be required to give a notice at that time. If later the AFTAP increases above 80% and in this particular plan, participants whose benefits were restricted, could not get a lump sum, now have the option to receive a lump sum, a new 101(j) notice is required to those participants.

Also if you have more than one restriction applying, say the 436(d) restriction on lump sum payments and the plan is frozen under 436(e), both of those restrictions can be combined into one single 101(j) notice.

On slide 9, when must notice be given? By the basically 30 days after any of these restrictions apply. The restriction applies also when the plan's UCEB event occurs that would cause the AFTAP to be below 60%. For example, may the actuaries that certified the plan to be an 82% AFTAP percentage therefore no restrictions apply. Then an event occurs that would necessitate payment of the UCEB benefits and that event causes the plan's AFTAP to fall below 60%. There's no actuarial certification, nonetheless an ERISA 101(j) notice is required 30 days after that event that causes the UCEB benefits to kick in. And other events that may be determined by the Secretary of Treasury.

On slide 10 then, how is the notice under ERISA 101(j) to be provided? Well it can be provided in paper or electronic form. There's actually a example of a good notice that's given in Notice 2012-46. There's a coordination under ERISA 101(j) and ERISA 204(h).

For example, ERISA 204(h) requires a notice if the plan is amended to restrict future benefit accruals or if the rate of future benefit accrual is greatly reduced. 101(j) requires a notice ~~that~~ when the 436 restrictions kick in. If you consider an example where a plan is amended to cease future benefit accruals, even though the AFTAP may be 90%, you would be required to give an ERISA 204(h) notice at that point. If later the AFTAP drops below 60% such that lump sums are restricted, you would then be required to give a 101(j) notice in addition to the previously given ERISA 204(h) notice.

Okay moving on to slide 11. We have some recent guidance under Notice 2012-70, the deadline for making 436 amendments. Basically it's the last day of the first plan year beginning on or after January 1, 2013 or the last day of the plan year for which 436 is first effective for plan or the due date if extension for filing the employer's tax return.

For most existing plans that's going to be the last day of the 2013 plan year. Previously in Notice 2011-96 there was a 436 sample amendment that was given and the date for adopting the 436 language in the plan was December 31, 2012 in the case of a calendar year plan.

It's possible that plans that are applying for favorable determination letters in 2013 under that prior guidance would be required to make the amendments under 436. However, the IRS is not currently ruling on 436 language so rather than have a plan be required to adopt an amendment for 436 that the IRS is not ruling on, the deadline for adopting those amendments has been extended by Notice 2012-74.

As I say for existing plans, like in a calendar plan year case to the end of the 2013 plan year. Another very important topic we want to cover is EPCRS for defined benefit plans and this is on slide 12. The new revenue procedure 2013-12 updates the IRS correction program for qualified plans.

The old previous revenue procedure was 2008-50. The new procedure makes a number of important distinctions and verifications. First of all it specifies that delays in payments for defined benefit plans should be increased at the plan's actuarial equivalent factor. The old 2008-50 simply says that the benefit should be increased actuarially. It's now clear that the increase should be tied to the plan's actuarial equivalence.

Corrective distributions from missed payments that were not subject to 417(e) when they should have been made do not need to be increased using the 417(e) present value factors. For example, one of the very common errors we find upon examination is the failure of the plan to make the required distributions under 401(a)(9). If you discover that a participant should have received a distribution under 401(a)(9), the proper correction is to make those distributions actuarially increased.

When those distributions under 401(a)(9) were required to be made to the participant they were not subject to the 417(e) interest and mortality; therefore, when you make the benefit distribution to that participant you're not required to increase those amounts with the 417(e), rather you would use the plan's actuarial equivalent factor.

On slide 13, failures involving 436 restrictions. Another very common problem that we're finding upon examination of defined benefit plans are issues under 436, basically failures by the plan to comply with the restrictions on benefits under Code section 436. 436 has been around since 2008. We didn't have the new EPCRS until just last year so we had 2008, 2009, 2010 when we were finding issues under 436. Well how do we correct them? The good news is now we have the new EPCR that gives us some guidance on how we can correct some of these errors. Under section 602(4)(b) of the new EPCRS provision, there was a correction principle added to reflect possible restrictions under 436 and to deal with the plan's failure to comply with 436 in operations.

Corrective contributions are generally required to be made to the plan to pay for corrective distributions or amendments while the plan was subject to 436 restrictions. For example, suppose the plan provided a UCEB benefit, a unpredictable contingent event benefit, and it actually paid those benefits when the AFTAP was below 60%. Well that's a violation of 436(b).

The correction for that plan is to pay into the plan the amount of the UCEB benefit with interest. It leaves the plan in a good position because the plan actually pays the UCEB benefit in violation of the Code no doubt, but that liability is now extinguished under the plan.

Yet because the EPCRS correction required the plan sponsor to pay into the plan the value of that benefit, the plan no longer holds the liability, but it does have the assets because of the corrected contribution. That's a good thing because obviously if a plan's AFTAP is below 60% it's not fully funded and the correction under the EPCRS is to get the plan in a better funded position.

Moving on to slide 14, another common issue we find on examination of plans is the failure to obtain spousal consent on distributions. The EPCRS correction comes to our aid here as well. One option, if the plan has not gotten the proper consent is to pay a lump sum to the spouse equal to the survivor annuity. Yes – this is described in Appendix A .07 of Rev Proc 2013-12.

What happens though if the plan is going to pay a lump sum to the spouse who did not consent to the distribution and therefore is entitled to this lump sum but the plan is under a 436 restriction when it seeks to do that? Well again the plan can pay into the plan the amount of the prospective lump sum that is being paid to the spouse.

On slide 15, the correction of overpayments. Section 6.06(3) of the new EPCRS was revised to clearly address the correction of overpayments made from defined benefit plans. Defined benefit overpayments must be corrected using rules similar into Appendix B. What those rules say basically you must make reasonable steps to have the money returned to the plan. You

must notify the participant that this overpayment is not eligible for rollover or any of the special tax treatments that apply to distributions from qualified plans.

On slide 16 under section 6.06(4) of the new EPCRS procedure, if you can't have the money returned to the plan, the employer can pay into the plan the value of that distribution. There were some modifications to the appendixes in the new EPCRS. On slide 17, contributions are required where the plan is subject to 436(d) restrictions if the plan fails to pay the required distributions under 401(a)(9) but makes the corrected distribution.

Another error that may occur is if the plan includes participants too early, that these participants are not eligible to be included in the plan but were, a special contribution could be made equal to the increased benefits of these participants, the increase of the funding target, for these improperly included participants.

On slide 18 we have an example of correction under 436 under the new EPCRS. In this case, the plan's AFTAP is below 60% in 2010 and the participant receives a lump sum distribution. It fails 436 because 436(d) restricts lump sums in such a situation. The plan sponsor discovers this error in 2012. The plan does allow for lump sum distributions, so what is the applicable correction under the EPCRS?

On slide 20, the correction is given. You can treat this as an overpayment. You want to try to secure the lump sum back from the participant. If you're unable to secure the lump sum back with earnings and the employer contributes to the plan the amount of the lump sum and that's the correction under the new EPCRS procedure. At this point I'll turn the presentation over to Carol.

Carol: Thanks Larry. I'm going to start out by talking about some guidance that we've recently issued and then turn to some pending projects, starting with MAP-21 on slide 21. By now I'm sure that all of you are aware that MAP-21 provided relief in the form of 25-year average interest rates which, under current economic conditions, are significantly higher than what would have been used otherwise.

Starting from that, we issued a couple of notices with the interest rates for 2012 and 2013. At 2012 those rates were done on an estimated basis, in the interest of time. 2013 took a little bit longer because the Treasury economists actually went back and filled in all the historical rates using the same sort of methodology that's used for the ongoing interest rates.

The good news is now that we have that history built and we can do the 25-year average, you would not expect delays in the future like we had for 2013 because at this point all we'll have to do is add the new year and recalculate the average. You would expect to see the MAP-21 rates available in the regular monthly notices updating the interest rates. We also issued general guidance in notice 2012-61 which covered some of the application rules under MAP-21.

Looking at slide 22, MAP-21 and the notice both specify applications where the MAP-21 rates do not apply and you see those there -- plans that are using the full yield curve, the deductible

limit under 404(o), minimum present value (lump sums for instance), excess assets for transfer under section 420, and then certain PBGC applications.

Moving on to slide 23, the way that the statue is set up is that if an application is not listed on that list of exclusions, then MAP-21 rates apply. People have been using the MAP-21 rates for minimum required contributions under 430, benefit restrictions under 436, and determining whether a qualified plan is in at-risk status so that they know whether or not they can fund the nonqualified plan.

Where this default structure does not work is where an application is addressed in the regulations and not directly from the statues. We are still awaiting guidance on whether or not MAP-21 rates apply when using the high-25 rules or the hybrid plan interest crediting rates.

Until guidance is issued, practitioners need to use reasonable interpretation. My understanding is that for the time being we're willing to accept MAP-21 or non-MAP-21 rates, either one, for these applications pending guidance.

Going on to slide 24, we've had a number of questions about how the transition rules work if a plan is applying MAP-21 for the 2012 plan year for 436 purposes. The key thing to remember is these transition rules really only apply if a pre-MAP-21 AFTAP had been certified before September 30, 2012. Basically what we did is we drew a line on September 30th saying that we've expected that anything done after that point was taken with full knowledge of MAP-21.

These transition rules would not affect, first of all, the presumption period, and it wouldn't affect the plan if the first AFTAP certified for 2012 is reflecting the MAP-21 rate and it doesn't affect any AFTAPs that were first certified after September 30th. If a plan does fall within the transition rules, the sponsor has a choice as to whether to apply MAP-21 retroactively or prospectively.

Of course this whole discussion is assuming that the plan sponsor is applying the MAP-21 rates for 2012, and they obviously have the option to defer those to 2013. Moving on to slide 25, if the plan sponsor decides to use the MAP-21 rates prospectively, that's the default. There's no specific election needed.

This runs through the same principles as the deemed immaterial change in our 436 regulations. That allows them to apply a change prospectively without worrying about, for the most part, about correcting distributions that were made prior to that date. One of the requirements for falling within the deemed immaterial change rules is the new AFTAP has to be recertified as soon as practicable.

In Notice 2012-61 we deem that to be as soon as practicable if it's recertified by 12-31-2012. That date, as the 09-30 date, applies regardless of the plan year. Those are based on when the guidance was issued, not the particular plan year.

I know some people have expressed concern that that deadline was too tight, the 12-31 deadline. Keep in mind that date only applies for situations in which the AFTAP for the plan was already certified, a valuation was done, and AFTAP was certified by September 30th -- so this gives three months to restate that liability based on the MAP-21 rates.

When we talk about the prospective application there are a couple caveats. One is, that under the notice the new rates would have to apply from the earlier of October 1 or the date that the MAP-21 certification is redone. If it is certified after October 1, then you may some retroactive corrections. Also the basic 436 regulations may require some retroactive corrections for unpredictable contingent event benefits or plan amendments that were restricted earlier in the year, but would be permitted under the new AFTAP.

Going on to slide 26, if the plan sponsor decides to apply MAP-21 retroactively, that does require an election. The retroactive application only goes back to the initial AFTAP certification. It does not affect the presumption period.

Moving on to slide 27 then, there are some limited abilities to make some changes for actions that were taken before that September 30, 2012 date. Plan sponsors can recapture reductions in funding balances and re-characterize 436 contributions, but not if that would cause any unpaid minimum required contributions or any new 436 restrictions. Slide 28 shows a summary of the deadlines for various elections associated with MAP-21. I will not go through each one of them, but most of them apply based on the form 5500 filing deadline.

An important thing to note is that the <u>decision</u> as to whether to make some of these elections may have to be made earlier if it's affecting things like 436 benefit restrictions and other elections that have earlier deadlines.

Going on to slide 29, another piece of guidance that was issued recently was the defined benefit list of required modifications. This is language that not only is designed to be used with the preapproved program, but it also provides a good resource for people that are designing individual plans as well. This language is posted on the IRS website. The best way to find it would be to just type in "list of required modifications" into the search box.

Moving on to slide 30 then, I wanted to talk about some of the projects that we're working on currently. Probably the next piece that you'll see from us is supplemental guidance on PRA 2010. This is the sequel to notice 2011-3, and covers some areas that weren't fully addressed earlier.

One thing to note is that we recognize that some of these rules have been in effect for several years now and that people have had to make decisions and make reasonable interpretations, so you can expect that this guidance will provide for a great deal of flexibility.

On slide 31, we talk about finalizing several proposed regulations. One is the final regs for section 430 that were issued in proposed form in April 2008. We're also working on finalizing the proposed bifurcation rules under 417(e)(3) that were issued about a year ago in February,

and working on some of the QLAC regulations that were issued in proposed form at the same time.

Of course, one of the things that we spend a great deal of time on is working on the hybrid plan regulations. We understand how important those are to folks. We also understand how difficult the issues are so we want to make sure that we take the time we need to get it right.

Going on to slide 32, one of the ongoing projects is updating the Schedule SB. That has a fairly long lead time. In fact, I think we've just about finished the 2013 SB and getting ready to hand that over to the software providers so that they can do their programming. That will be released to the public early in 2014. We're already getting started on the 2014 SB, so are trying to keep ahead of that.

Another project that we have is the second round of proposed regulations on sections 430 and 436. This deals with a number of the difficult issues that we didn't tackle the first time around and also deals with some of the legislative changes that have occurred in the meantime. One of the things that you can expect to see in that project would be some additional guidance on plans with year-end valuations.

On slide 33 then, I show some other projects that are getting started now. One thing that I think people have been looking forward to is guidance on changes in funding methods. A big part of that is updating the revenue procedure dealing with automatic approvals. Revenue procedure 2000-40 has not been updated for the Pension Protection Act so in its current form it does not apply to plans that are subject to the section 430 minimum funding rule.

I know that people have been anxious to use that. We needed some time to see what kind of requests were coming in and what sort of things people needed to see and which things worked, which things wouldn't work for automatic approval. As we're updating that we're also going to be updating the procedure for requesting approval that's currently under Revenue Procedure 2000-41. Again that hasn't been updated so the information that's requested isn't always applicable when you're dealing with plans subject to section 430.

Last but not least on my list, there is a project to update the mortality tables. Notice 2008-85 provided the static mortality tables for use through 2013. Obviously we're getting to the end of that so people have been asking for an update and we're working on that currently. That ends my summary and I will turn it over to Mike.

Mike: Hello everyone. I want to start by looking at the new 2013 dollar limits. I'm not going to really go over these, but for those of you who don't have a little chart of these taped to your wall as I used to when I was in private practice, you might print this out and just tape it to the wall.

Notice we've had a few changes and a couple that did not. I'd like to talk about 415 and the 415 regulation specifically that were updated in 2007 and how they made some changes that I don't know that everyone caught. They're a little bit different in that it talks about limiting not only

the benefits that can be paid it has to preclude the possibility an annual benefit will be accrued as well.

In the past I think that there was a lot of thought that the 415 limit was something that only applied to benefits that were paid but in effect, the plan could accrue a benefit in excess of the amount that was paid and then there would be adjustments made to the 415 limit and then in effect the 415 limit would apply to the benefit in the end.

The thinking has been that that might, it actually probably would result in an impermissible forfeiture of benefit in that if you have actually accrued a benefit that cannot be paid, that that constitutes a problem. Slide 36, to talk about an example of a plan that needs to preclude the possibility that any annual benefit exceeding these limitations will be accrued or payable in any optional form of course that includes the not in the normal form.

Here's an example on page 37. Let's look at a 415 limit $205,000, the dollar limit. The plan benefit calculated under the benefit formula prior to this application of 415 is $400,000. Here the plan reduction factors to pay a benefit at age 62, 85% reduction for early commencement, and a 90% adjustment for 100% QJSA.

This is how quite frankly before the new regs came out a lot of people were doing this. Certainly I could say the regulations didn't make it crystal clear that this was not allowed although some people that felt for a long time that this was not the correct calculation.

What one would do in this case is you would take the $400,000 times the adjustments and get $306,000, not $3 million as we have incorrectly in the slide with an extra zero, and then the plan would restrict the benefit to the dollar limit of $205,000. In this case, after making the adjustment and then applying the 415 limit, the plan would still be able to pay $205,000 at age 62 as a 100% QJSA.

Here we have exactly the same factors, same fact pattern but the accrued benefit is first limited to $205,000. The QJSA table at age 62 is now the $205,000 with the adjustments which brings us to $156,825. It is important to note, however, that this adjustment for QJSA is only because the plan benefit in normal form was not the QJSA.

If the plan had provided that the normal form was an unreduced 100% QJSA, there would be no adjustment performed. I'd like to move on to talk about 415 and its application to hybrid plans. One particular plan design that I've seen and I'd like to back up and make a comment that because hybrid plans are defined benefit plans, they need to satisfy 415.

And 415 limits an annuity benefit and so the hybrid plans are going to need to specify how they satisfy section 415 on the basis of an annuity form of benefit and not on the basis of either the hypothetical allocations or the actual hypothetical account balance.

What I've seen is some plans try to construct a failsafe schedule to principal credits. Each principal credit is a lump sum at some point in time, they divide that by 10, take the present

value of that, let's say 65, 64, 63, 62 and then that's the schedule of principal credits that are allocated to people.

The thinking is well each year since the 415 dollar limit is phased in over 10 years, that in any one given year, nobody is receiving the present value in a lump sum form of more than one-tenth of the 415 dollar limit. I'd like to make the point that I've changed some of the numbers here on this so when we repost the slides you'll see them.

I had somebody point out correctly to me that we had some incorrect numbers. I'm going to work with the numbers I have that you'll see in your slides. The 415 dollar limit assumed is $205,000. We have no preretirement mortality and a preretirement interest discount of 5% and the age of 65 annuity conversion factor is 120.

The schedule has come up with the principal credit as you see here of $46,821 at age 31 all the way up to $246,000 at age 65. The error in this slide of course is its implying that the 415 limit at age 65 is $246,000, not $205,000. Again you'll see these fixed in the new slides that come out.

If someone were to indeed receive these principal credits from age 31 through 65 accumulating at 5% interest, it's going to accumulate to a hypothetical account balance of about $8.4 million which is equivalent to an annual retirement benefit of about $840,000. It says $700,000 here but that would be actually the more correct number.

The issue is it's clearly not a safe harbor design with respect to section 415. One also needs to keep in mind that they may not fund for a benefit in excess of the 415 dollar limit. Let's talk about what it means to limit the accrued benefit of the 415 limit in a hybrid plan situation.

But does that mean that you somehow have to limit the hypothetical account balance? Remember it is merely a bookkeeping account. I think of it as if the benefit is calculated through the benefit formula as in the defined benefit plan where in my prior example, the benefit formula produces an annuity benefit of $400,000 but 415 comes in and limits that.

Once the benefit formula, in this case the hypothetical account balance, comes up with a benefit payable to which 415 would apply, then 415 would be applied to that benefit. It does not mean that the hypothetical account balance must be reduced in the interim.

Let's look at what it means to have an accrued benefit in a hybrid plan because I hear more often than not at conferences people mentioning to me that their hybrid plan defines the accrued benefit simply as the hypothetical account balance and of course post PPA that's completely allowed. That's not quite true; 411(a)(13) if you look at it talks about how one may avoid whipsaw.

What it says is that under terms of the plan the present value of the accrued benefit is expressed as the balance of hypothetical account or current value of accumulated comp in a

PEP situation. 411(b)(5) talks about comparing benefits to similarly situated younger individuals.

In other words looking to see if the plan is age discriminatory for this purpose only, the accrued benefit may be expressed as an annuity, a hypothetical account balance or the current value of accumulated comp in a PEP. However, Code section 411(a)(7) if you like to cruise through the Code like I do, you will find that it says for the purposes of Code section 411, the term accrued benefit, in a defined benefit plan, is the accrued benefit determined under the plan.

And except as provided in (c)(3), has to be expressed in the form of an annual benefit commencing at normal retirement age. If we look at (c)(3) we find that if the plan itself determines the accrued benefit as something other than an amount at an annual annuity commencing at normal retirement age, then the accrued benefit for section 411 will be actuarial equivalent of such a benefit.

What we're getting back to is 411(b)(5) says that for the purposes of age discrimination only, the plan may define the accrued benefit as the hypothetical account balance. For all other purposes under section 411 at least, the plan must have a definition, it must somehow come up with an annual benefit at normal retirement age that represents the accrued benefit.

If the plan doesn't normally define it as such, then 411(c)(3)(A)(i) tells you that the plan must convert the representation of the accrued benefit to an annual benefit commencing at normal retirement age. Again, people who think that the requirement that a hybrid plan provide an annuity as the accrued benefit; that that requirement has been removed through PPA, it's not completely correct.

It has been changed only for age discrimination purposes. That interestingly enough doesn't only apply to a hybrid that just talks about how a defined benefit plan may comply with age discrimination. Sections 411, 415, 416 and 417 all apply to an accrued benefit as described in 411(a)(7)(i).

As I just said, the hybrid plan needs to contain provisions describing how the hypothetical account is converted to an annual accrued benefit. Otherwise that accrued benefit will not be definitely determinable and we all know that definitely determinable in a defined benefit plan is very, very important.

I'm going to move to talk about offset cash balance plans. We've been seeing more and more of these. Offset plans were something that I saw in private practice 20 years ago off and on. The defined benefit plan provides the benefit as a normal defined benefit plan would be so many dollars per month at retirement.

With it will be paired generally a profit sharing plan. The profit sharing plan will accumulate benefits as normal but the defined benefit plan will have a provision saying that upon commencement of benefits that the benefits paid from the defined benefit plan are reduced by the actuarial equivalence of the benefits provided in the profit sharing plan.

This is provided in Revenue Ruling 76-259 which actually reverses the position I believe from 1969 whereby the IRS did not like the offsets but Revenue Ruling 76-259 came back and said we've reconsidered our position, they are allowed and it gives us some rules.

The defined benefit plan must provide the basis with which the offset will be determined otherwise you're going to have a problem with definitely determinable benefits if that conversion is left solely to the discretion of the employer at any given point in time.

Also the defined benefit plan must specify when the determination is made. This has to be in a manner again which precludes employer discretion which would also give us a definitely determinable problem. The offset to the defined benefit plan benefit may only be done on the basis of the vested portion of the profit sharing account balance, because it wouldn't be right to offset the entire defined or part of the defined benefit plan balance by the entire profit sharing account if that entire profit sharing account is not actually payable to the participant. We got a couple examples here and we've been seeing these more.

This is a new design issue and we've seen them on the slide 50 that I call Incorrect offset design. We have been seeing more of these than we'd like. The concept here is that you have a cash balance plan and it says that the principal credits, the amount credited each year as a principal credit, is for example here 10% of compensation but reduced by the employer discretionary allocation of the profit sharing plan for the same year, of course not below zero.

The design that we're seeing is generally graduated or paid credits or just people in different groups within the cash balance plan where the non-highly compensated people are getting a very small principal credit and a large enough profit sharing discretionary contribution that when you subtract the profit sharing plan contribution from the principal credit, they are receiving actually no principal credit whatsoever in the cash balance plan.

The only person in the cash balance plan who is receiving any principal credit is generally the highly compensated employees or the owners. This type of benefit design however is not allowed because Revenue Ruling 76-259 provides that the offsetting accrued benefit has to be related to the account balance, not the annual allocation in DC plan.

If you think about how this would work over time, even a very small amount of money in a profit sharing plan that is credited with earnings will grow to be greater than zero and such that if you use that to offset what's in the cash balance plan, at least the cash balance plan if the person has received actual principal credits, is going to have a real benefit to be offset by something in the profit sharing plan.

Whereas if the entire principal credit is offset each year by the profit sharing allocation, then when it comes time to offset there is actually no benefit in the cash balance plan to be offset. Let's look at how it should work … slide 51. Cash balance plan distinctly provides the definition of principal credits as 10% of compensation.

However, the annuity benefit payable is the annuitized value of the cash balance account less the actuarially equivalent annuity based on the vested account balance of the profit sharing plan equivalent to the discretionary employer contributions. Of course you may not offset in any offset design, you may not offset the defined benefit by any employee contributions such as 401(k) deferrals.

This is the way it should be done. I've had some people say well can't we just offset the cash balance account by the accumulated profit sharing account? I would say there is a very, very specialized situation in which the math works out exactly right and that can be done but again it's a phone forum and we don't have a lot of time to get into that so I'm not going to go over that.

I think sufficed to say that that's not generally the case. If I were designing an offset cash balance plan, I would definitely look at my offsets as described on slide 51. With that, I believe I could turn it back over to Larry Heberle. He's going to talk about some multiemployer reports. Larry?

Larry: Thank you Mike. That was very interesting. One of the fascinating things about the pension field is you have something like Revenue Ruling 76-259. That's a very, very old revenue ruling and yet it's very pertinent to practice in the world today. Thank you. That was interesting.

Okay well in the time that remains I think I'd like to address some recent reports that have been issued to Congress regarding the multiemployer plans and the specialized world of multiemployer defined benefit plans. It's a bit of a specialized field, but it's not an insignificant portion of the pension field at all as the reports that I'll describe in greater detail discuss.

There are approximately 1,500 multiemployer plans in America and they cover approximately 10 million participants. These are a rather significant portion of the pension security for America. All right then on to slide 52, the multiemployer reports. In January of this year the PBGC issued three reports to Congress regarding the multiemployer insurance program.

The colloquial terms that are given to these three reports are first of all the free agency report. Secondly, the five year report and thirdly the annual exposure report and that's how I'll refer to them as I discuss them. The reports may help Congress as they address future challenges for the multiemployer statement of the pension world as we go forward.

On to slide 53 to discuss the first of these reports, the three agency report. A little bit of background here. Under PPA there were I'm sure most of you are quite aware very significant changes to the single employer funding regime under PPA versus the ERISA regime that we had prior to PPA.

In the multiemployer role it's not quite that way. The changes to multiemployer funding rules were much less dramatic than were the changes PPA made for the single employer plans. Nonetheless, PPA did make some changes to the multiemployer world.

As a bit of a background, under Code sections 431, 432 we have the zone certifications that are required for multiemployer plans. The actuary is to value the plan and then certify the zone status each year. A green zone status means the plan is well funded. That's a good thing. A yellow zone status is endangered meaning that the plan is endangered. It's not as well funded as we would like.

Then a red zone status is critical. These are the plans that are most susceptible to insolvency, most susceptible to necessitating PBGC involvement and the liability to the agency of the government. That's a bit of the background.

Under section PPA 221(a), Congress after making these rules, these zone certifications, the Code section 431, 432 rules, told the PBGC and the Department of Labor and the Treasury of which the IRS is part, those three agencies: PBGC, Department of Labor and Treasury, "well study the effects of these changes, these PPA changes on multiemployer plans and report back to us."

That was the charge that Congress gave in section 221(a). The agencies undertook the responsibility and prepared the report. What's striking is in the report is the effect that the market crash of 2008 had on multiemployer plans. At the beginning of 2008, virtually all multiemployer plans used the beginning of the year valuation.

At the beginning of the 2008 plan year for multiemployer plans, 77% of plans were certified to be in the green status meaning they were well funded, they had enough funds to pay benefits, they were chugging along just fine. After the market crash of 2008, that is when we look at the zone certifications beginning in 2009 for the same plans, only 32% of the plans were certified to be in the green zone status.

The rest were either yellow or red, endangered or critical so a dramatic effect of the market crash on the funding status of these multiemployer plans. With the PPA options and the funding relief that came under WRERA and PRA 2010, the funding status of multiemployer plans is gradually improving.

By 2011, 60% of the multiemployer plans are reporting a green or comfortable funding status, but there's serious challenges that remain. The report, the three agency report to Congress, does not make any policy recommendations per se. It more or less outlines the status of multiemployer plans, has a lot of statistics, a lot of information, but it doesn't make any specific policy recommendations to Congress.

It does note that even though 60% of the plans in 2011 may be certified as green, there are challenges that remain because ~~a lump~~ some of that 60% really reflects the funding relief that came in PRA 2010 and WRERA and so on. If we simply went back to the PPA regime and we didn't have this funding relief, we wouldn't have 60% of the plans reporting a green status. It may be a little rosier picture than the reality would suggest.

All right, the second report is the five year report and this is the stuff on slide 54. This is required under ERISA, section 4022(A)(f)(1). On each five years, PBGC is required to report to Congress basically how is it going, how is the premium structure working, are they collecting a premium revenue to support the benefit guarantees and so on. As an insurance agency, how are you getting along?

The takeaway that we would have under the five year report that was issued to Congress just this year, January 2013, is that the current structure under multiemployer plans, the current premium structure will not support the benefit guarantees in the long run. It's a dire as we look out into the future from multiemployer plans, it's a cloudy picture.

The sunset of the PPA provisions may allow the opportunity for Congress to look at changes to the multiemployer plan going forward that maybe alleviate some of these funding issues. Similar to the three agency report, the five year report also does not give any specific policy recommendations to Congress.

The third of the reports on slide 55, is the exposure report. This is a report that PBGC prepares to analyze their exposure as an insurance agency, exposure to these underfunded or insolvent multiemployer pension plans. These [inaudible 00:58:43] method of modeling the future.

"This is a stochastic method of modeling the future."

They run 500 different economic scenarios. The exposure report shows a significant deterioration in a few large plans is really threatening the solvency of the PBGC going forward. Under the exposure report directly from the report it states that there's a takeaway I guess, there's a 36% chance that the PBGC multiemployer program will become insolvent in 10 years and there's a 91% chance that the PBGC multiemployer program will become insolvent in 20 years.

Insolvency here means that they won't be able to pay the benefits that they've guaranteed and promised to pay. If nothing changes, on slide 56 the PBGC says the multiemployer program will be in trouble in the future. This may provide a opportunity for Congress to make some changes when the provisions of PPA sunset in 2014.

A way for government and employers will have an interest so we will wait and see what Congress decides with respect to the multiemployer pension program. This concludes our presentation.

If you have any questions you can forward them to RetirementPlanQuestions@IRS.gov. All one word -- RetirementPlanQuestions@IRS.gov -- and we'll get those questions and endeavor to get back to you soon as we can. Thank you for listening in today and I hope you enjoyed our presentation.