PRUDENTIAL RETIREMENT. INTELLIGENT SOLUTIONS, WORKING FOR YOU.

Pension ANALYST

Important Information   Plan Administration and Operation   February 2007

PBGC and DOL Provide Guidance to Defined Benefit Plans

<u>WHO'S AFFECTED</u> These developments affect sponsors of qualified defined benefit plans that are subject to PBGC premium and DOL disclosure requirements, including cash balance plans and multiemployer plans. Governmental plans and plans sponsored by churches that do not elect to be covered by ERISA (“non-electing church plans”) are not subject to these rules.

<u>BACKGROUND AND SUMMARY</u> Sponsors of qualified defined benefit plans that are subject to the ERISA plan termination insurance rules must file and pay annual plan termination insurance premiums to the Pension Benefit Guaranty Corporation (PBGC). The PBGC may assess penalties on plan administrators and plan sponsors for failing to pay premiums. The purpose of this penalty is to encourage plan sponsors to pay premiums in full and on time, and to voluntarily self-correct any failure to do so. Recently, the PBGC published guidance regarding its policy for granting premium penalty waivers and provided specific examples where the PBGC may grant a penalty waiver. The guidance also includes factors the PBGC considers in determining whether to grant such a waiver.

In addition, the PBGC announced the 2007 inflation adjusted flat-rate premium for single-employer plans and multiemployer plans. These rates are automatically adjusted for wage inflation as required by the Deficit Reduction Act of 2005.

The PBGC also announced the maximum monthly guarantees for plans that terminate in 2007. While participants become 100% vested in their accrued benefits upon plan termination, the PBGC limits benefit guarantees to certain amounts. These amounts are published annually.

Finally, the Department of Labor (DOL) recently issued a model notice that is required by the Pension Protection Act of 2006 (PPA). This notice enables a defined benefit plan that had previously elected to be treated as a single-employer plan to revoke that election and be treated as a multiemployer plan, provided it satisfies certain requirements.

<u>ACTION AND NEXT STEPS</u> The guidance described in this *Pension Analyst* affects the calculation of the 2007 flat-rate per participant premium. Plan sponsors and their advisors should familiarize themselves with the information contained in this publication and discuss any questions or concerns they may have with the plan’s enrolled actuary.

IN THIS ISSUE

Premium Penalty Waivers

ERISA requires certain qualified single-employer and multiemployer defined benefit plans to pay annual plan termination insurance premiums to the PBGC. ERISA also authorizes the PBGC to assess penalties for the failure to pay such premiums. A premium penalty is owed by any person that is liable for the premium, generally the plan administrator or contributing sponsor.

Overview

The final rules, which apply to PBGC actions taken on or after December 18, 2006, define a "premium penalty" as a penalty for failure to pay a premium in full and on time. A "penalty waiver" is a reduction or elimination of a premium penalty. When deciding to grant a penalty waiver, the PBGC considers the facts and circumstances of each case.

Under the final rules, the PBGC may grant a penalty waiver in the following situations:

- ***Provisions of law.*** A penalty will be waived if a law or regulation requires such action. For example, penalty waivers are required in certain business hardship situations.
- ***Reasonable cause.*** The PBGC will waive a premium penalty, in whole or in part, if the plan administrator or the person responsible for paying the premium shows reasonable cause for a failure to pay a premium in full and on time. If there is reasonable cause for only a part of a failure to pay a premium, the PBGC will waive the premium penalty only for that part.
- ***Legal errors.*** The PBGC may waive all or part of a premium penalty if the failure to pay a premium results from an erroneous interpretation of the law or a recent change in the law. In general, the PBGC *will* waive a premium penalty if the filer calls an erroneous interpretation of law to the attention of the PBGC. However, if the erroneous legal interpretation is not disclosed, the PBGC *may* waive a premium penalty only if the weight of authority supporting the interpretation is substantial in relation to the weight of opposing authority and it is reasonable to rely on the interpretation.
- ***Pendency of PBGC procedures.*** A penalty may be waived when the violation is due to a PBGC review or other procedure that is pending.
- ***Other circumstances.*** A premium penalty may be waived if the PBGC determines it is appropriate to do so. However, the PBGC intends to exercise this discretionary waiver authority only in narrow circumstances.

Reasonable Cause

The most common reason for waiving a premium penalty is "reasonable cause." The PBGC generally finds that there was reasonable cause in failing to pay a premium in full and on time if the failure:

- Occurred due to circumstances beyond the control of the person responsible for the payment; and
- Could not be avoided by exercising ordinary business care and prudence.

The size of the organization and the premium involved may affect the PBGC's expectations regarding ordinary business care and prudence. For example, a larger organization might be expected to establish more comprehensive backup procedures than a smaller organization for dealing with situations such as computer failure or the loss of important records. In addition, more care and prudence should be used to make sure a larger premium is timely and correctly paid.

In determining whether it is appropriate to waive a premium penalty due to reasonable cause, the PBGC will consider the following factors:

- What event or circumstance caused the underpayment and when did that event or circumstance occur;
- How did the event or circumstance prevent the plan administrator from paying the premium in full and on time;
- Whether the event or circumstance could have been anticipated; and
- How the plan administrator responded to the event or circumstance, including what steps were taken and how quickly they were taken to pay the premium and how other business affairs were conducted.

Simply overlooking legal requirements is not considered a reasonable cause.

When making a reasonable cause determination, the PBGC will consider neither the cost of collecting the premium nor the cost and risks of enforcing the premium penalty.

The final rules provide the following examples where reasonable cause may be found.

- The person responsible for taking action was suddenly and unexpectedly absent or unable to act.
- A fire or other casualty or natural disaster destroyed relevant records or prevented compliance.
- There was reasonable reliance on erroneous oral or written advice given by a PBGC employee.
- The required information, including records and calculations, necessary to comply, was not available.

In certain situations, the PBGC may grant a partial penalty waiver for reasonable cause. *For example. A fire destroyed the records needed to compute a premium payment. If in the exercise of ordinary business care and prudence it takes one month to reconstruct the records and pay the premium but the premium is paid two months late, it might be appropriate to waive that part of the premium penalty attributable to the first month the payment was late, but not the part due to the second month.*

Action or Inaction of Outside Party

The final rules acknowledge that a plan administrator may rely on the advice of an outside accountant, actuary, lawyer, or pension consultant. The PBGC will not take this into consideration in waiving a penalty and outside advisors will be treated as if they were part of the plan administrator's organization.

2007 Flat-Rate PBGC Premiums

The Deficit Reduction Act of 2005 increased the flat-rate per participant premium for both single-employer and multiemployer plans. For plan years beginning in 2007 and later, these premiums are adjusted annually for inflation, applying the same wage base used for Social Security indexing, rounded to the nearest dollar.

The PBGC has published the 2007 flat-rate premium amounts. For single-employer plans, the premium increases from $30 to $31 per participant. The multiemployer flat-rate premium remains $8 per participant for 2007.

PBGC Maximum Monthly Guarantees

Upon plan termination, a participant becomes 100% vested in his or her accrued benefit. In the event of a distress termination or a termination initiated by the PBGC, the PBGC may use its own assets to pay benefit obligations to current and future retirees if the terminated plan has insufficient assets. However, the PBGC does not guarantee all vested accrued benefits and limits its benefit guarantees to specified amounts. For example, the PBGC guarantees "basic benefits" earned before the plan terminated, which include the following:

- Pension benefits at normal retirement age;
- Most early retirement benefits;
- Annuity benefits for survivors of plan participants; and
- Disability benefits for disabilities that occurred before the plan termination date.

The maximum guarantee amount is set by law and applies for the year of termination, even if the participant does not retire for several years. Annually, the PBGC publishes the maximum guarantee. Recently the PBGC published its maximum guarantee tables for plans terminating in 2007. For single-employer plans that terminate in 2007, the maximum guaranteed monthly benefit paid by the PBGC is $4,125.00. This is the maximum payable in the form of a life annuity commencing at age 65. If the benefit is payable in a different form or begins at a different age, the maximum guaranteed benefit is the actuarial equivalent of $4,125.00.

The PBGC does not impose a dollar limit on the monthly benefit for multiemployer plans. However, the PBGC does limit the benefit rate used to calculate the monthly benefit which is not annually adjusted.

DOL Publishes Multiemployer Model Notice

Within one year of the enactment of the Multiemployer Pension Plan Amendments PPA of 1980 (i.e., by September 26, 1981), a multiemployer plan could irrevocably elect not to be treated as a multiemployer plan if certain requirements were satisfied. This election exempted the plan from the employer withdrawal liability provisions that were included in that legislation.

PPA now allows any multiemployer plan that made this type of election to revoke it if the plan satisfied the multiemployer plan requirements for each of the three plan years before August 17, 2006. The revocation election must be made before August 17, 2007. It will be effective beginning with the first plan year ending after August 17, 2006, and will be irrevocable.

In addition, no later than 30 days before an election is made, the plan must provide notice of the pending election to each:

- Plan participant and beneficiary;
- Labor organization representing such participants or beneficiaries; and
- Employer that has an obligation to contribute to the plan.

The notice must describe the differences between the PBGC guarantees and benefit restrictions for a single-employer plan and those for a multiemployer plan. A failure to provide the notice is treated as a failure to file an annual report and a penalty of $1,100 per day applies. The DOL has now published a model notice that plans may furnish to participants and other interested parties to describe this type of election.

Next Steps

Plan sponsors should become familiar with the 2007 flat-rate per participant premium so that their PBGC premium filings and payments reflect the correct amount. They should also become familiar with the situations in which the PBGC may waive the payment of premium penalties. If Prudential Retirement provides the actuarial services for your plan, you may want to discuss any questions with your Prudential enrolled actuary.

Pension Analyst by Prudential Retirement
The Pension Analyst is published by Prudential Retirement, a Prudential Financial business, to provide clients with information on current legislation and regulatory developments affecting qualified retirement plans.

Editor: Mitzi Romano (860) 534-2768