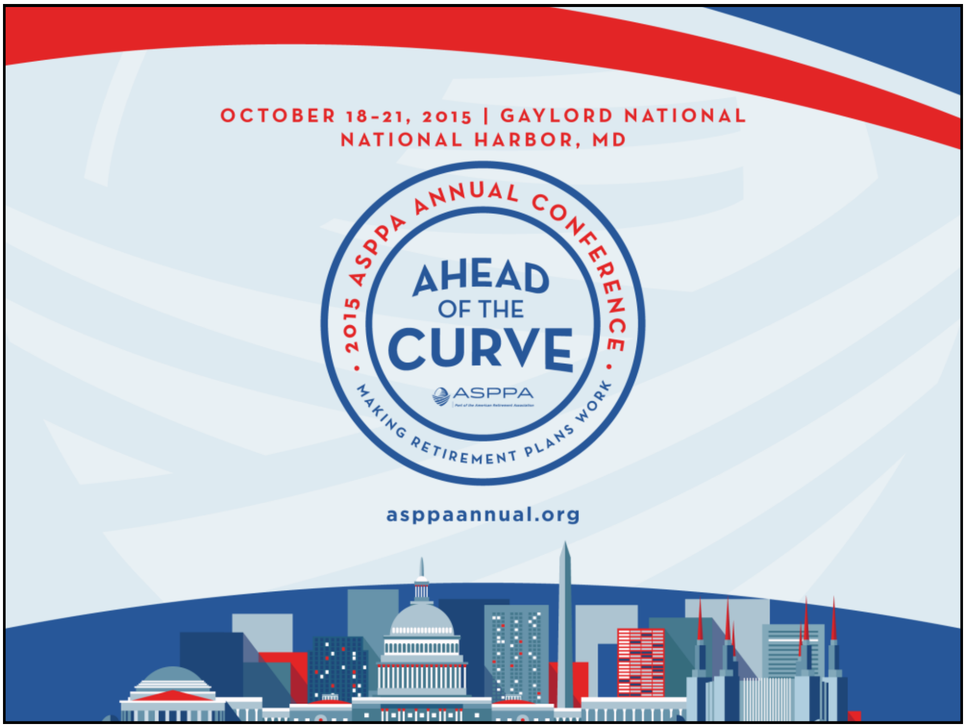

DB Plan Funding Strategies and the use of Credit Balances
Workshop 11

2015 ASPPA Annual Conference

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2

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Key

- Carryover Balance = COB
- Prefunding Balance = PFB
- Funding Target = FT
- Target Normal Cost = TNC
- Beginning of Year = BOY
- End of Year = EOY
- Presumed Adjusted Funding Target = PFT
- Employer/sponsor = you or me (if I say “you” or “me” I probably mean the plan sponsor)
- Minimum Required Contribution = MRC

Assumptions

- During the following presentation and for all of the examples, assume the following:
  - There have been no annuities purchased
  - There have been no amendments or UCEBs
  - The prior year AFTAP has been timely certified (before the first day of the 10^{th} month)
  - The plan is not subject to collective bargaining agreement
  - PYB after 12/31/07 is first effective year

What are they?

- Carryover Balance (COB)
  - The carryover balance is the leftover credit balance from pre-PPA years.
  - Contributions/credits in excess of absolute minimum required amount.
  - Final regulations clarified that a COB is automatically created if the credit balance was greater than $0 at the end of the pre-effective plan year. 1.430(f)-1(b)(2)(i)

What are they?

- Prefunding Balance (PFB)
  - Present value of contributions in excess of required minimum contribution.
  - Employer/sponsor must make specific election with regard to the amount of the excess that will be used to create or added to a prefunding balance. 1.430(f)-1(f)(1)(i)

What are they?

- Prefunding balance (cont.)
  - The maximum amount that may be elected to be added is the excess contributions on the valuation date plus interest at the effective rate to the first day of the next plan year.

  1.430(f)-1(b)(1)(ii)(A), (B), and (iv)(A)

What are they?

- Prefunding Balance (cont.)
  - The final regulations clarified that an election to add to a prefunding balance is an election to maintain a prefunding balance. 1.430(f)-1(b)(1)(i)
  - Alternatively, the sponsor may make a standing election to add the maximum amount possible to the prefunding balance. 1.430(f)-1(f)(1)(ii)

What can they be used for?

- Toward satisfying the minimum required contribution (including quarterlies)
- Burn to allow use of balance(s) in following year
- Burn to eliminate funding shortfall (to avoid quarterly contributions in next year)
- Burn to increase the AFTAP (presumed)
  - May be deemed or elective
- Burn to increase the AFTAP (the real one)
  - May be deemed or elective

Note: Carryover balance must be used before prefunding balance.

Using Balances toward Minimum

- Employer/sponsor must elect to use the balance before the due date of the applicable minimum funding date. This is a change from proposed regulations. 1.430(f)-1(f)(2)(i)
- The balance may only be used if the prior year “funding ratio” was at least 80%. In this case funding ratio means (AVA – PFB) ÷ Funding Target. 1.430(f)-1(d)(3)

11

Using Balances toward Minimum

- The amount available is “as of” the valuation date.
- Beginning of Year Valuation
  - Use the balance as of the beginning of the year.
- End of Year Valuation
  - Use the balance at the beginning of the year brought forward to the valuation date at the effective rate of interest. 1.430(f)-1(b)(5)(i)

12

Using Balances toward Minimum

- What is the amount available at the valuation date?
- Beginning of Year Valuation
  - Amount at beginning of prior year less amount used and any elective reduction for the prior year. 1.430(f)-1(b)(3)(i)
  - Remaining amount is brought to the beginning of the next year at the actual rate of return for that year. 1.430(f)-1(b)(3)(i)

13

Using Balances toward Minimum

- Beginning of Year Valuation (cont.)
  - New amount added to PFB
    - Present value of contributions as of valuation date in excess of minimum required contribution plus interest at the effective rate to the first day of the next plan year. 1.430(f)-1(b)(1)(ii)
  - The amount of excess contributions attributable to the use of a credit balance to offset the minimum is updated at the actual rate of return. 1.430(f)-1(b)(3)(iii)

14

Using Balances toward Minimum

- End of Year Valuation
  - Amount available was brought forward from the first day of the plan year to the EOY at effective rate. 1.430(f)-1(b)(4)(i)
  - Amount left would be amount determined above minus the amount used.
  - That leftover amount is then brought back to the beginning of the year at the effective rate.

15

Using Balances toward Minimum

- End of Year Valuation (cont.)
  - The beginning of year amount is then brought to the beginning of the next year at the actual rate of return for the year. 1.430(f)-1(b)(4)(ii)
  - New amount added
    - Present value of contributions as of valuation date in excess of minimum required contribution plus interest to the first day of the next plan year at the effective rate. 1.430(f)-1(b)(1)(iv)(A)

16

Using the Balances toward minimum

- End of Year Valuation (cont.)
  - New amount added
    - The amount of excess contributions attributable to the use of a credit balance to offset the minimum is discounted to the beginning of the year at the effective rate and then updated at the actual rate of return to first day of the next plan year.

      1.430(f)-1(b)(4)(ii) and (iii)

Using Balances toward the Minimum

- Caution 1: If an election was made in the current year to use a portion of the balance toward the MRC toward the prior year, and current year elective or deemed reductions occur, special adjustments are needed to re-determine the amount available for the prior year MRC. (example later) 1.430(f)-1(d)(1)(ii)(D)

Using Balances toward Minimum

- Caution 2: If an election was made in the current year to use a portion of the balance toward the MRC for the current year and a later elective or deemed reduction occurs, the amount available to use toward the MRC is retroactively reduced. (example later) 1.430(f)-1(d)(1)(ii)(B)

Example 1-BOY

- Beginning of year Val 1-1-14
- Facts:
  - COB=15,000
  - PFB=0
  - 2014 Eff Rate=6%
  - 2014 Actual ROR=5%
  - MRC on Val Date= 10,000
- Amount available to use: 15,000
- Election made to use 10,000 of COB

Example 1-BOY

- Amount remaining for 1-1-2015 Val
  - COB is 5,000 plus actual ROR interest
  - 5,000 * (1.05)
  - 5,250 is 1-1-2015 COB

Example 1A-BOY

- Now assume after electing to use the COB, the sponsor makes a contribution with a 1-1-14 present value of $15,000.
- PV of excess contributions is $15,000 but $10,000 is attributable to the election to use the COB to offset the minimum. The remaining $5,000 is a result of cash contributions in excess of the MRC.

Example 1A-BOY

- Amount COB remaining for 1-1-15 Val
  - COB = (15,000 – 10,000) plus interest at the actual ROR = 5,000*1.05 = 5,250
- Amount available to add to PFB at 1-1-15
  - 10,000 plus interest at the actual ROR plus
  - 5,000 plus interest at the effective rate
  - 10,000*1.05 + 5,000*1.06 =
  - 10,500 + 5,300 = 15,800
    (total balances 21,050)

Example 1A-BOY

- If no election to use COB and contributed $15,000, COB = 15,750

  and PFB would be $5,300.
  (total balances 21,050)

Example 2-EOY

- End of Year Val 12-31-14
- Facts:
  - 1-1-14 COB=5,000
  - 1-1-14 PFB=10,000
  - 2014 Effective Rate 6%
  - 2014 Actual ROR 5%
  - 2014 MRC at 12-31-14 $10,000
- Amount Available as of the Val Date
  - 5,000 * 1.06 + 10,000*1.06 = 5,300 + 10,600 =15,900

25

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Example 2-EOY

- Election made to use 5,300 of COB and 4,700 of PFB
- Amount remaining as of beginning of 2015 year
  - COB is gone
  - PFB at Val Date= 10,600 – 4,700 = 5,900
  - PFB left at beginning of 2014= 5,900/1.06 = 5,566
  - PFB as of 1-1-2015 = 5,566 * 1.05 = 5,844

26

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Example 2A-EOY

- Now assume a contribution with an EOY value of $15,000 is made.
- PV of excess contributions at val date is $15,000.

Example 2A-EOY

- Amount of COB remaining
  - COB is gone
- Amount available for PFB at 1-1-15
  - Of the 15,000 excess, 10,000 is due to the use of the balances.
  - 10,000/1.06*1.05 = 9,906 plus
  - 5,000
  - Amount available to add to PFB = 14,906
  - Total PFB could be (14,906+5,844)=20,750

Example 2A-EOY

- If they had not elected to use the balances, the COB would be 5,250 and the PFB would be (10,500+5,000)=15,500.
(total balances 20,750)

Reduce to allow use in next year

- Funding ratio must be at least 80% in the prior year to allow use of balance. 1.430(f)-1(d)(3)
- Determination of the funded status only subtracts prefunding balance, not carryover balance.
- So, if PFB has been created and funding ratio falls below 80%, employer/sponsor may want to consider reducing/or not creating as large of a PFB to allow the use of the balances in the following year. Remember, COB must be reduced first.
- Election to create a PFB has to be made by the minimum funding deadline for the year in which the excess contributions were made.
1.430(f)-1(f)(2)(i)

Burn to avoid quarterly contributions

- If FTAP (AVA-COB/PFB) ÷ FT is less than 100%, but AVA ÷ FT is greater than 100%, then may want to reduce the balances to get the FTAP to at least 100%.
- Said differently, if FT – (AVA – COB/PFB) is greater than 0, but FT – AVA is less than 0, then may want to reduce the balances to get the FTAP to at least 100%.
- This would eliminate the quarterly contributions requirement in the following year.
- This election would have to be made by the end of the applicable plan year. 1.430(f)-1(f)(2)(iii)

31

Example 3-avoid Quarterlies

- 1-1-14 AVA=100,000
- 1-1-14 FT=95,000
- 1-1-14 COB=15,000
- Funding shortfall exists, so will be subject to quarterlies in 2015.
  - Funding Shortfall= 95,000–(100,000–15,000)=10,000

32

Example 3-avoid Quarterlies

- Election made to reduce 1-1-14 COB by 10,000
- Funding Shortfall no longer exists
  - Funding Shortfall=
  - 95,000–(100,000–5,000)=0
  - No quarterlies in 2015

Burn to increase Presumed AFTAP

- During the Presumption Period
  - Determine of the presumed AFTAP
  - Have to know the interim value of assets and the COB/PFB at the valuation date.

Burn to increase Presumed AFTAP

- Determine the presumed AFTAP
  - First three months it is prior year's AFTAP
  - First day of the fourth month it is the presumed AFTAP minus 10%, but only if prior year AFTAP was at least 60% but less than 70% or at least 80% but less than 90%.

35

Burn to increase Presumed AFTAP - (first three months)

- Determine the interim value of assets
  - Value of assets at valuation date – ignore:
    - Contributions made after the Val Date
    - Elections made after the Vale Date to add to PFB
    - Elections made after the Val Date to use the COB/PFB

      1.436-1(g)(2)(ii)(B)(1)

36

Burn to increase Presumed AFTAP - (first three months)

- Determine the Presumed Adjusted Funding Target
  - Divide interim value of assets minus COB/PFB by the presumed AFTAP.

1.436-1(g)(2)(ii)(B)(1)

37

Burn to increase Presumed AFTAP - (first three months)

- Required or deemed burn
  - If AVA < 60% PFT, no burn
  - If AVA>Transitional % of PFT (96% for 2010), no burn– Transitional % does not apply anymore
  - If presumed AFTAP>80%, no burn
  - If 60%<Presumed AFTAP<80% but AVA>80%PFT, calculate burn. This is only applicable if the plan provides for accelerated payments.
  - If Presumed AFTAP <60% and AVA>60%PFT, calculate burn. If accruals are frozen and plan does not pay accelerated payments, this is N/A.
  - Burn is COB/PFB – (AVA – 80%/60%PFT)

38

Burn to increase Presumed AFTAP - (first day of fourth month)

- Do it all over again at as of the first day of the 4th month unless actual AFTAP is done.
- Reflect prior deemed burn
- Reflect any contributions for the prior year and elections made to use the COB/PFB for the prior year as of first day of 4th month. 1.436-1(g)(2)(ii)(C)

39

Burn to increase Presumed AFTAP

(first day of fourth month)

- If presumed AFTAP is eligible for the transition rule (prior years funding levels met transition rules) and presumed AFTAP is equal to or greater than the threshold, for the current year, don't subtract COB/PFB.
- This is important when calculating the inclusive presumed AFTAP to determine if a burn is required to allow an amendment to go into effect.

40

Example 4-Presumed AFTAP

1-1-09 FT	600,000
1-1-09 AVA	450,000
1-1-09 COB	20,000
AVA / FT	75.00%
AFTAP (truncated per SB instructions)	71.66%
Actual 2009 ROR	25%
1-1-10 AVA	750,000
1-1-10 COB + PFB	125,000
AVA – Balances	625,000
1-1-10 Presumed AFTAP	71.66%

41

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Example 4-Presumed AFTAP

1-1-10 Presumed FT	872,174
80% Presumed FT	697,740
Required Burn	72,740
Remaining Balance	52,260
AFTAP	80.00%
4-1-10 Presumed AFTAP	70.00%
1-1-10 AVA	750,000
1-1-10 COB	52,260
AVA – Balances	697,740
Presumed FT	996,771

42

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Example 4-Presumed AFTAP

80% Presumed FT	797,417
60% Presumed FT	598,063
Required Burn	0
Remaining Balance	52,260
1-1-14 AFTAP (as of 4-1-14)	70.00%

Example 5-Presumed AFTAP

1-1-13 FT	1,000,000
1-1-13 AVA	910,000
1-1-13 COB	100,000
AVA / FT	91.00%
AFTAP	81.00%

Actual 2013 ROR	25%
1-1-14 AVA	1,350,000
1-1-14 COB + PFB	225,000

No presumed AFTAP necessary since no restrictions

Example 5-Presumed AFTAP

4-1-14 Presumed AFTAP	71.00%
1-1-14 AVA	1,350,000
1-1-14 COB+PFB	225,000
AVA – Balances	1,125,000
Presumed FT	1,584,507
80% Presumed FT	1,267,606
60% Presumed FT	950,704
Required Burn	142,606
Remaining Balance	82,394
1-1-14 AFTAP (at 4-1-14)	80.00%

Timing of Elections

- Per final regulations, if during the presumption period, a portion of the balance was deemed to be burned, the amount available to use toward the prior year's minimum required contribution is based on the adjusted balance at the beginning of the prior year. 1.430(f)-1(d)(1)(ii)(A)

Example 6-Recalc Available Balance BOY (deemed reduction before election to use toward prior year MRC)

1-1-14 COB	10,200
1-1-14 PFB	58,573
2014 effective rate	6.5%
2014 Actual ROR	7.0%
Deemed reduction in COB/PFB as of 4/1/15	68,500

Sponsor elects to use entire COB/PFB toward 2014 MRC on 5/1/15

47

Example 6-Recalc Available Balance BOY

Amount of balances available to use toward minimum

1-1-15 COB	10,200*1.07=10,914
1-1-15 PFB	58,573*1.07=62,673
Deemed reduction in COB	10,914
Deemed reduction in PFB	57,586
1-1-15 Remaining PFB	5,087
Adjusted back to 1-1-14	5,087/1.07=4,754
PFB available for MRC in 2014	4,754

48

Example 6-Recalc Available Balance - BOY

Sponsor elects to use entire 4,754 balance for 2014 minimum

1-1-15 COB (prior to deemed reduction)	(10,200-4,754) *1.07 =5,827
1-1-15 PFB	58,573*1.07=62,673
Deemed reduction in COB	5,827
Deemed reduction in PFB	62,673
1-1-15 Remaining PFB	0

49

Example 7-Recalc Available Balance EOY
(deemed reduction before election to use toward prior year MRC)

1-1-13 COB	10,000
1-1-13 PFB	55,000
2013 effective rate	6.0%
2013 Actual ROR	10.0%
12-31-13 Balances (for MRC)	65,000*1.06=68,900
Deemed reduction in COB/PFB as of 4/1/14	68,500

Sponsor elects to use COB/PFB toward 2013 minimum on 5/1/14

50

Example 7-Recalc Available Balance EOY

Amount of balances available to use toward minimum

1-1-14 COB (for AFTAP)	10,000*1.1=11,000
1-1-14 PFB (for AFTAP)	55,000*1.1=60,500
Deemed reduction in COB	11,000
Deemed reduction in PFB	57,500
1-1-14 Remaining PFB	3,000
Adjusted back to 1-1-13	3,000/1.1=2,727
PFB available for MRC in 2013	2,727*1.06=2,891

51

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Example 8-Recalc Available Balance BOY (election to use for current year before election to use for prior year)

1-1-14 COB	40,000
1-1-14 PFB	0
2014 Actual ROR	25.0%
1-1-15 COB	50,000
Election on 3/1/15 to use toward 2015 MRC	40,000

Election on 4/1/15 to use some COB toward 2014 MRC

52

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Example 8-Recalc Available Balance - BOY

1-1-14 Value of 3/1/15 election	40,000/1.25 =32,000
1-1-14 COB after 3/1/15 election	40,000-32,000 =8,000

COB available for 2014 MRC is 8,000

53

Example 9-Recalc Available Balance - EOY (election to use for current year before election to use for prior year)

1-1-13 COB	40,000
1-1-13 PFB	0
2013 Actual ROR	25.0%
2013 Effective Rate	6%
12-31-13 COB for MRC	42,400
Election on 3/1/14 to use toward 2014 MRC	40,000

Election on 4/1/14 to use entire balance toward 2013 MRC

54

Example 9-Recalc Available Balance - EOY

1-1-13 Value of 3/1/14 election	40,000/1.25 =32,000
1-1-13 COB after 3/1/14 election	40,000-32,000 =8,000
12-31-13 COB available for 2013 MRC	8,000*1.06 =8,480

55

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Example 10-Recalc Available Balance BOY

(deemed reduction reduces amount available for MRC)

1-1-14 COB	10,200
1-1-14 PFB	58,573

Sponsor elects to use 68,000 of COB/PFB toward 2014 minimum on 3/1/14

Deemed reduction in COB/PFB on 4/1/14	68,500
Amount now Available for 2014 MRC	273

56

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Example 11-Recalc Available Balance - EOY (deemed reduction reduces amount available to use for current year)

1-1-13 COB	10,000
1-1-13 PFB	55,000
2013 Actual ROR	10%
2013 Effective Rate	6%
12-31-13 Amount Available for MRC	68,900

Sponsor elects to use 50,000 toward 2013 MRC on 3/1/13

Deemed reduction on 4/1/13	30,000

Example 11-Recalc Available Balance EOY

Amount now available for 2013 MRC

Deemed reduction in COB	10,000
Deemed reduction in PFB	20,000
Remaining 1-1-13 PFB	35,000
Amount now Available for 2013 MRC	35,000*1.06 =37,100

Burned to increase AFTAP (the real one)

- Required Burn
  - At the time of certification
    - If there is enough COB and/or PFB to burn that would cause the AFTAP to increase to one of the thresholds, 60% or 80%, then it must be burned. No election is necessary.
    - However, if the plan does not offer accelerated payments, then no burn is required between 60% and 80%. If no accelerated payments and plan is already frozen, no burn if less than 60%.

Burn to increase AFTAP (the real one)

- Optional Burn
  - To make sure presumed AFTAP will be over the threshold in the following year.
  - If AFTAP is less than 90% but would be at least 90% if some or all of COB/PFB was burned, then may want to consider this.

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The Final Question…

- Are these credits worth it?
  - If funding ratio is below 80%, can't use them anyway
  - If no balances, no burn, no election to reduce, no presumed AFTAP worries, no re-do of MRC if the sponsor does decide to elect to use the balance toward the minimum, more sleep?

61

Example 12 With and Without Balances

	No Balances	Balances
1-1-09 FT	1,000,000	1,000,000
1-1-09 TNC	100,000	100,000
1-1-09 AVA	800,000	800,000
1-1-09 PFB	0	250,000
Funding Shortfall (94% test)	yes	yes
Funding Shortfall Amount	140,000	390,000
Shortfall Amortization	23,333	65,000
Excess Assets	0	0
MRC as of 1-1-09	123,333	165,000
Minimum if elect to use PFB	123,333	0
Maximum	800,000	800,000

62

Example 13
With and Without Balances

	No Balances	Balances
1-1-09 FT	1,000,000	1,000,000
1-1-09 TNC	100,000	100,000
1-1-09 AVA	1,100,000	1,100,000
1-1-09 PFB	0	250,000
Funding Shortfall (94% test)	no	no
Funding Shortfall Amount	0	0
Shortfall Amortization	0	0
Excess Assets	100,000	0
MRC as of 1-1-09	0	100,000
Minimum if elect to use PFB	0	0
Maximum	400,000	400,000

63