#### 2015 NIPA Annual Forum & Expo (2015NAFE)

Shi Da National Institute of Pension Administratory

#### A Review of DB Distribution Basics

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New Relationships. New Ideas. New Look. A New Way to Look at NIPA

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Mary Ann started her actuarial consulting firm in 1987 in Huntington Beach, CA. Her firm provides actuarial services to pension administration firms with a specific focus on designing both Traditional and Cash Balance Plans intended to maximize benefits for business owners. Mary Ann was elected to the College of Pension Actuaries ("COPA") board of directors in 2006 and served as President of ASPPA's College of Pension Actuaries ("ACOPA") in the 2009-2010 year. She is currently serving on the Ed Burrows Award Nominating Committee as well as presenting at various conferences throughout the country.





- Traditional DB Plan Lump Sum Distributions.
- Cash Balance Plan Lump Sum Distributions.
- § 436 (d) Restrictions on DB Lump Sum Distributions
- § 401(a)(4)-5(b) Restrictions on DB Lump Sum Distributions
- Required Minimum Distribution (RMD) impact on DB Lump Sum Distributions
- Maximum DB Lump Sums under § 415



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- Your system may generate factors which are slightly different, yet no less accurate
- Rounded values are being used in situations where I would not actually round.



- Traditional Defined Benefit (DB) <u>Pension</u> Plans, by definition, provide a Participant with a monthly benefit payable at NRA.
- Unlike DC Plans, the employer bears the risk of investment returns.



## Example 1:

Formula = 10% of pay x YOP payable as a Single Life Annuity (SLA)

Celine's Hi 3 Avg Comp = \$200,000 YOP = 6

Monthly Accrued Benefit =  $200,000 \div 12 \times .10 \times 6 = $10,000$ 



- The value of Celine's \$10,000 benefit is unchanged by the returns in the DB trust.
- The benefits is <u>required</u> to be paid as a monthly annuity unless the Plan offers the option to pay the benefit as a lump sum (and the Participant elects it).
- If Celine is married the Plan says her automatic form a 50% Joint & Survivor Annuity at NRA.



- The value of the 50% J&S Annuity is the AEQ of Celine's benefit payable at NRA.
- If paid as a 50% J&S Annuity, Celine's benefit will be reduced from \$10,000 to \$9,250 payable at NRA.
- Actuarial equivalent means the two benefits have the same lump sum value.



 The same amount of money would need to be deposited in an account (earning the AEQ interest rate) to pay Celine \$10,000/mo at age 62 for her lifetime compared to

 \$9,250/mo until her or her spouse passes away, then 50% (\$4,625) until the other one passes away.



- Many large Plans don't offer lump sums or allow benefits to be paid before NRA.
- Conversely, most of us in the small Plan world rarely see annuity benefits paid monthly from our DB Plans or Annuities purchased outside the Plan
- In XX years I've dealt with an annuity provider once.



- Lump Sum distributions are the Present Value of the Accrued Benefit (PVAB) of the benefit payable at NRA.
  - Based on Plan Defined AEQ assumptions
- Cannot be less than the minimum present value calculated under § 417(e)(3)(D)\*.
  - More complicated than pre-PPA when 417(e) rates employed the same methodology as Plan PVAB.

\*We will refer to § 417(e)(3)(D) as 417(e).

# Signa Traditional DB Plan Lump Sums

#### Plan PVAB

- Use interest and mortality assumptions defined in Plan document.
- Discount from Normal Retirement Age (NRA) to Attained Age (AA) using interest only unless Plan specifies pre-retirement mortality.

#### 417(e) Minimum PVAB

- Applicable Mortality table based on IRS issued table for the calendar year that contains the first day of the Stability period, as defined in Plan document.
- Applicable Interest is based on the <u>three</u> segment rates of the applicable lookback month, as defined in the Plan document.



- 417(e) Minimum PVAB (continued)
  - Segment 1 rate applies to benefit payments in the first 60 months (5 years).
  - Segment 2 rate applies to benefit payments in the next 180 months (15 years).
  - Segment 3 rate applies to benefit payments more than 240 months away (over 20 years



#### • 417(e) Minimum PVAB (continued)

- Some practitioners apply pre-retirement mortality to the 417(e) calculation, some do not.
- Some documents address it by having a section to choose to apply or not apply pre-ret mortality 417(e), some don't address it.
- The IRS seems to lean towards having pre-ret mortality by default apply in 417(e) calculations.
- Whichever approach you take, make sure it doesn't not contradict specific Plan document language.



- 417(e) Minimum PVAB (cont)
  - Stability Period

One Month One Calendar Quarter

- One Plan Quarter One Calendar Month One Plan Year
- Lookback Month
  - 1st month4th month2nd month5th month3rd month
- Averaging of any number (2-5) of any consecutive Lookback Months if document specifies



- When does a lump sum change?
- It can change daily/weekly/monthly depending on the method used to determine the lump sum
  - Age in completed months
  - Exact Age
  - Other reasonable method



- Administratively not feasible.
- Will typically calculate as of a specified date (as of date) and lock into some period of time, ie 30, 60 or 90 days.
- If actual payment occurs later, then lump sum value should be recalculated



## Example 2 – Lump Sum Distribution

**Plan Facts:** 2015 Calendar Plan Year Normal Retirement Age = attainment of age 62. Plan Actuarial Equivalence (AEQ): 5.00% pre and post retirement interest 1994 GAR (unisex) post-retirement mortality,. No Pre-ret mortality



### 417(e)(3) Actuarial Assumptions:

Interest = Applicable Interest rate in effect at time of distribution.

Pre and Post Retirement mortality = Applicable Mortality Table in effect at time of distribution.

Stability Period = 1 Plan Year

Lookback = 1 month



**Participant Facts:** Name: Terry Date of Birth (DOB): 8/1/1958 Norman Retirement Date (NRD): 8/1/2020 Attained Age (AA) = 57Accrued Benefit (AB) = \$2,000 Vested Percent = 100%

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- Calculation 'as of' date = 8/1/15,
- Terry's exactly 5 years from NRD.
- Plan PVAB = benefit at NRD x Annuity Purchase Rate (APR) at NRD discounted 5 years.
- $$2,000 \times 152.1573^* \div (1.05)^{5} = $238,438$

\*APR – cost of \$1 monthly benefit payable at age 62.



417(e) Assumptions Mortality = 2015 Applicable Mortality Table December 2014 (lookback month) 417(e) Segment Rates= Segment 1 = **1.48%** (0-5 years) Segment 2 = 3.77% (6-20 years)

Segment 3 = **4.79%** (over 20 years)

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- Payment date = 5 years from NRD.
- Seg 1 Factor = -0-
  - no payments under segment 1
- Seg 2 Factor = 104.8046
  - PV at 3.77% of deferred and temp annuity payable from age 62-77)
- Seg 3 Factor = 30.1322
  - PV at 4.79% of deferred annuity payable from age 77
- 417(e) factor<sup>\*</sup> = 134.9368

\*with pre-ret mortality



- 417(e) PVAB = \$2,000 x 134.9368 = **\$269,874**
- Plan PVAB = \$238,438
- Lump Sum payable on 8/1/15 = \$269,874



- If pre-retirement mortality were not used in this calculation the 417(e) factor would increase from 134.9368 to 137.6962.
- The 417(e) minimum LS would increase to \$2,000 x 137.6962 = \$275,392 vs \$269,874
- The more years away from retirement the more significant the difference will be.



- If the actuary sets the calculation for a 90 day period the values expire on 10/30/15.
- What if Terry returns his signed election forms on 12/1/15 (after the calculation expiration date)?
- The lump sum calculation should be updated.



### Example 3 – Plan PVAB updated Lump Sum

- If using exact age method, Terry is 57.33 years old using 12/1/15 as the ASD.
- New payment date = 4.67 years from NRD.
- Terry's Plan PVAB revalued =
  \$2,000 x 152.1573 ÷ (1.05)<sup>4.67</sup> = \$242,309



### Example 3 – 417(e) updated lump sum

- Seg 1 Factor = 3.5927
  - PV at 1.48% of deferred temp annuity payable from age 62 62.33
- Seg 2 Factor = 104.4229
  - PV at 3.77% of deferred temp annuity payable from age 62.33 to 77.33)
- Seg 3 Factor = 29.4347
  - PV at 4.79% of deferred annuity payable from age 77.33
- 417(e) factor<sup>\*</sup> = 137.4503



- 417(e) PVAB = \$2,000 x 137.4503 = \$274,901
- Plan PVAB = \$242,309
- Lump Sum payable on 12/1/15 = \$274,901
- Compared to \$269,874 valued on 8/1/15



- What if Terry returns his signed election forms on 12/1/15 but the check is ready to issue on 1/5/16?
- Is Terry's lump sum valued on the 2015 or 2016 assumptions?

# Signa Traditional DB Plan Lump Sums

- Early January would be a reasonable administrative delay to use the original calculated amount (2015 Table/Dec 2014 Segment rates).
- Under § 417(f)(2)(A)(ii) Annuity Starting Date means, in the case of a benefit not payable in the form of an annuity, the first day on which all events have occurred which entitle the Participant to such benefit.
- All events occurred when Terry returned his forms\*.



- How far do you take this? What if Terry was paid at the end of January?
- Does it matter which direction the lump sum will go (up or down)?
- Safest approach may be to pay the greater of the two unless you have a Plan that clearly addresses the situation



# Example 4 – 417(e) definition examples

# Plan Year = 5/1/14 - 4/30/15 Stability Period = One Plan Quarter Lookback month – 2 month



The four stability periods: 05/01/14 - 07/31/14  $08/01/14 - 10/31/14 \leftarrow 2 \mod back$   $11/01/14 - 01/31/15 \leftarrow payment in this quarter$ 02/01/15 - 04/30/15

# Payment Date = 12/1/14 Mortality = 2014 Applicable Table Segment Rates = September 2014



Change Payment Date to 4/1/15 The four stability periods: 05/01/14 - 07/31/14 08/01/14 - 10/31/14  $11/01/14 - 01/31/15 \leftarrow 2 \text{ month look back}$ 02/01/15 - 04/30/15 ← payment in this quarter Mortality = 2015 Applicable Table Segment Rates = December 2014

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 Review the Plan's stability period to know when the 417(e) rates change and incorporate that into the time period you 'set' the calculation.



- Plans that use a 1 Month Stability period must recalculate the lump sum on the 1st day of every month.
- DON'T DO IT!!!
- If the definition is amended you must preserve the greater of the old and new definition for 1 year.



- Cash Balance Plans define the benefit by defining the lump sum (Hypothetical Account Balance or "HAB").
- The HAB consists of contribution credits and interest credits, both per the Plan document.
- Both are part of the benefit formula.

## Signa Cash Balance Plan Lump Sums

- If the Plan is drafted properly and qualifies as an 'applicable defined benefit Plan', benefits not subject to 417(e).
- The annuity benefit is determined by the value of the lump sum, not the other way around like a traditional DB.

# Signa Cash Balance Plan Lump Sums

- A cash balance Plan distribution is like any other DB Plan.
- Benefits over the cashout threshold (\$5,000 for most Plans) are still payable under the Plan's automatic annuity form.
- Spousal consent is still required to waive the QJSA.



- Most documents will specifically address a pro-rated interest credit for lump sum distributions that are made during the year.
- Interest credits often defined as monthly or quarterly.
- Some documents may refer to pro-rated interest credits in general terms.
- Some documents may be silent.



- If no reference to pro-rated interest the final Hybrid Plan regs seem to support no interest credit in year of distribution.
- Many actuaries are not comfortable with that, but doesn't mean it is wrong.
- In the absence of specific definition of what proration means, the Plan Administrator can establish a consistent approach.

# Signa Cash Balance Plan Lump Sums

- If you change the approach should treat as if it were a Plan amendment
- Would have to credit HAB prior to the change under the old way and HAB after the change under the new way
- Yuck



## Example 5 – Cash Balance LS Monthly Interest

**Plan Facts:** 2015 Calendar Plan Year Interest Crediting Rate = 5.00% AEQ - 1994 GAR 5.00% NRA = Attainment of age 62Interest credited for each full month through date distribution is made



#### Example 5 – Continued

**Participant Facts** Name: Garth DOP: 1/1/2011 DOT: 12/31/14 Hypothetical Allocation = 50,000 Garth's 12/31/14 HAB = \$215,506



#### Example 5 – Continued

### Date of Distribution = 8/1/15. (1+(7/12 x .05)) x \$215,506 = \$221,792\*

## If Date of Distribution = 9/1/15(1+( $8/12 \times .05$ )) x \$215,506 = \$222,690



#### Example 6 – Cash Balance LS Quarterly Interest

### Plan Facts the same except for Interest credited through each full quarter through date distribution is made



#### Example 6 – continued

Date of Distribution = 8/1/15. (1+(2/4 x .05)) x \$215,506 = \$220,894

## Date of Distribution = 9/1/15Same as above Date of Distribution = 10/1/15 $(1+(3/4 \times .05)) \times $215,506 = $223,587$



#### Example 6 – continued

- Garth's lump sum distribution on 8/1/15 = \$220,894.
- The monthly accrued single life annuity benefit at NRD (age 62) = \$220,894 x 1.05<sup>5</sup> ÷ 152.1573 = \$1,852.84
- The monthly accrued single life annuity benefit at payment date (age 57): =
  \$220,894 ÷ 168.7738 = \$1,308.82



### Don't forget there are rules about the maximum Lump Sum Distributions that can be paid under § 415.



- § 436(d) Prohibited Payments determined by the Certified or Presumed AFTAP.
- Presumed AFTAP
  - prior year certified AFTAP,
  - prior year certified AFTAP reduced by 10%, or
  - deemed AFTAP (prior or current year) below 60%
- Applies to all Plan years
  - No exception for the first 5 Plan years like other 436 restrictions



IDa 436(d) Lump Sum Restrictions

Exception if Plan frozen prior to 9/1/05.

 Exception if the Lump Sum is less than \$5,000 regardless of the Plan defined cash-out threshold.

- Before a Lump Sum distribution can be paid first determine the current AFTAP to see if any restrictions apply.
- AFTAP at least 80% or more
  - Lump sum distributions can be paid.
- AFTAP at least 60% but less than 80%
  - Partial lump sum distributions can be paid.
- AFTAP is less than 60%
  - Full restriction on lump sum distributions

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- Partial restrictions (AFTAP >= 60 < 80%)</li>
- Prohibited payments are payments in excess of the <u>lesser</u> of:
  - 50% of the PVAB (including 417(e) assumptions)
  - Present value of the PBGC maximum guaranteed benefit (5,011.33 in 2015).

#### Terminated Participant required options

- Defer receipt of benefits to a later date
- Elect an immediate annuity option.
- Elect 50% of the PVAB now and take the remaining 1/2 vested accrued benefit in immediate annuity form
- A Plan <u>may</u> offer a participant the ability to the unrestricted 50% of the PVAB now and defer the election on the restricted portion until later.
  - Only if Plan language allows for it.
  - Would not allowing this would probably simplify administrative distribution procedures?



- Restrictions are applied using
  - Certified AFTAP
  - Presumed AFTAP
- Presumed AFTAP may be
  - prior year certified AFTAP,
  - prior year certified AFTAP reduced by 10%, or
  - deemed AFTAP (for prior year or current year) below 60%



- Three periods to consider for presumptions,
  - first 3 months of Plan year,
  - 1<sup>st</sup> day of 4<sup>th</sup> month until 10<sup>th</sup> month or current year certification, whichever comes first, and
  - 1<sup>st</sup> day of 10<sup>th</sup> month (if no timely certification

- If the Plan had a timely certified AFTAP in the prior year that AFTAP will be applicable for the first 3 months of the current year
  - the 2014 AFTAP will apply until 4/1/15 for calendar year.
- If the Plan did not have any AFTAP certified in the prior Plan year the Plan will have a presumed <60% AFTAP</li>



- If the Plan had a late AFTAP certified in the prior Plan year, the prior year is deemed <60% with full restrictions through the end of the Plan Year and the certified AFTAP will be applicable for the first 3 months of the current year
  - the 2014 AFTAP will apply until 4/1/15

- If the Plan had a timely certified AFTAP in the prior year but the AFTAP was either
  - At least 60% but less than 70%
  - At least 80% but less than 90%
- The 1<sup>st</sup> day of the 4<sup>th</sup> month rules will apply.
- The AFTAP will equal the prior year AFTAP less 10 percentage points.

- Why does it not matter if prior AFTAP was at least 70% but less than 80%?
  - Because if you subtract 10% you are in the same place with an AFTAP that is not over 80% (no restrictions) and not less than 60% (full restrictions.
  - The partial benefit restrictions for an AFTAP at least 60% but less than 80% stay in place.



### Example 7 – 436(d) Restriction

- Calendar Plan Year
- 2014 AFTAP = 89%
- On 4/1/15 the AFTAP drops to 79%
- 50% partial restriction applies unless a new AFTAP has been certified at 80% or more.



- When the the AFTAP for the prior year is 80% or more, but less than 90% the Plan may end up with restrictions in the current year.
- It makes sense to try to keep the AFTAP at 90% to avoid the presumptive rules that would restrict benefit payments.
  - May impact decisions to add to the Prefunding balance



## SIDA 436(d) Lump Sum Restrictions

#### Example 8 – 436(d) Restriction

- Calendar Plan Year with no certified AFTAP in 2014, presumed AFTAP is < 60% with full benefit restrictions starting 10/1/14.
- Actuary certifies late 2014 AFTAP at 69% on 2/1/15 so partial Benefit Restriction rules through 4/1/15.
- On 4/1/15 the presumed AFTAP is 59% full benefit restrictions now apply.
  - unless actuary certifies a 2015 AFTAP at 60% or more



- 401(a)(4)-5(b) Restrictions on Lump Sum distributions to HCE/restricted employees.
- Purpose to protect benefits of NHCE's.
- Often referred to as the 'Top/High 25' or '110%' rule.
- Definition of a restricted employee
  - Small Plans: it's any HCE or former HCE
  - Medium and Large Plans there are more complex criteria not covered here



- Accelerated distributions (lump sums) cannot be made to restricted employee unless
  - After taking into account the amount of the distribution for the restricted employee, the value of plan assets must equal or exceed 110% of the Plan's <u>current liabilities</u>.
- Not a lot of official regulatory guidance on how to calculate.
  - Can sometimes be a good thing.

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- Determination of Current Liability (CL) and Plan Assets
  - "...any reasonable and consistent method may be used in determining the value of plan assets and current liabilities."
  - Methodology for determining the current liability and assets may be changed from year to year.



- Post PPA non-multiemployer Plans no longer calculate Current Liability for Plan Years beginning after 12/31/07.
- What are the options?



- IRS indicated in the 2008 Gray Book that it's reasonable to either
  - continue to use current liability as previously defined
  - Also reasonable to assume current liability can be replaced with the Funding Target under PPA



- IRS indicated in the 2013 Gray Book that it's reasonable to either
  - Use pre-MAP-21 interest rates to calculate Funding Target
  - Use the Funding Target calculated under MAP-21 interest rates.
  - Must be consistent within the same plan year.



### IRS indicated in the 2014 Gray Book:

- If the Plan still refers to Current Liability under the High 25 the sponsor may want to consider amending the plan to say FT will be used to stand in for CL to not raise concerns about administrative interpretation.
- For the purpose of using MAP-21 or not using MAP-21 (and/or HATFA) it may not be reasonable to shift back and forth between plan years without compelling rationale.



### Example 9 – Top 25 Rule

#### 2015 Plan Year

HCE Cher terminates, wants her benefit as a a lump sum distribution.

2014 AFTAP certified over 100%.



401(a)(4)-5(b) Restrictions

#### Example 9 – continued

- Cher's PVAB/Lump Sum = \$205,000
- 1/1/15 Assets = \$405,000
- 1/1/15 Total Funding Liabilities (FT) = \$375,000
- 1/1/15 Liability attributable to Cher = \$175,000
- If \$205,000 lump sum payment is made:
  - Funding Liabilities = \$375,000 \$175,000 = \$200,000
  - Remaining Assets = \$405,000 \$205,000 = \$200,000.



401(a)(4)-5(b) Restrictions

- Assets = 100% of Liabilities
- Fails the 110% rule
- Some possible solutions?
  - Have Cher elect an annuity option not in excess of the Single Life Annuity benefit
  - Set up an escrow agreement with FMV 125% of the restricted amount.
  - Fund a \$20,000 contribution before the distribution so assets will be 110% of the liabilities after the distribution.



- Defined Benefit Plan Required Minimum Distributions (DB RMD).
- Calculated as a monthly annuity stream of payments usually beginning on April 1<sup>st</sup> following age 70.5 called the Required Begin Date (RBD).
- Typically paid as an annual annuity payment.
- Can no longer use the DC Account Balance method unless the entire benefit is being paid as a lump sum.



- If the annuity is not a QJSA form spousal consent is required.
- Consent applies to any increases in benefits after the RBD.
- If first payment delayed to RBD no doubling up like DC plans when paying as an annuity.
  - With exceptions if benefit fully distributed in the year that contains the RBD.



- Once the annuity commences the period may not be changed except:
  - Participant retires or the plan terminates.
  - The original annuity is a period certain without life contingencies
  - Participant marries and elects a QJSA



- When are RMD's paid as a lump sum?
  - At Plan Termination
  - If the Plan allows in-service distributions
    - Must be allowed in Plan document
    - Subject to 401(a)(4)-5 (110% rule) and 436 (AFTAP) benefit restrictions
- If benefit is paid as lump sum, the RMD portion not eligible for rollover can be determined
  - Using the annuity rules
  - Using the DC Account Balance method.



 If paying the entire accrued benefit as a lump sum in the year containing the RBD and the RMD for the first distribution calendar (year attains 70.5) has not already been made, then the RMD portion for the <u>first and second</u> distribution calendar year is not eligible for rollover.



#### Example 10 – DB RMD Lump Sum

- Liberace attains 70.5 in 2014
- First distribution year = 2014
- Monthly Accrued benefit = \$2,000
- RBD = 4/1/15
- No RMD was paid in 2014
- Plan terminates 1/1/15.



#### Example 10 – continued

- Liberace elects to receive his benefit as a Lump sum equal to \$274,000 in March 2015.
- Using the Account Balance Method for 2015 RMD
  - \$274,000 ÷ 27.4 (age 70) = \$10,000 +
  - \$274,000 ÷ 26.5 (age71) = \$10,340 =
  - **\$20,340** = Amount not eligible for rollover
- Other methods may be argued/used to determine the double payment under the account balance method.



- When doing RMD annuity calculations the form of payment can be in any optional form allowed under the plan.
- Best to advise the participant avoid any life contingent annuities.
- Why? Because there may be a forfeiture of the benefit upon death.
- The plan should be defined offer a term certain annuity and/or increasing term certain annuity.



- If looking for the lowest RMD annuity amount it will be an increasing term certain.
- This outline is using a single life annuity form to demonstrate the basic concepts.
- I would not do that in actual practice.



#### Example 11 – DB RMD Annuity Year 1

- Same facts except plan not terminating
- Liberace will begin RMD annuity payments on the RBD of 4/1/15.
- If RMD elected as Annual SLA:
  - \$2,000 x 12 = \$24,000.
  - If Liberace is married his spouse will have to consent to waive the QJSA.



#### Example 12 – DB RMD Annuity Year 2

- In 2015 Liberace earns another \$250 per month accrued benefit increase.
  - New RMD 'piece' = \$250 x 12 = \$3,000
  - Spousal consent required on the new 'piece'
- The total RMD payable on 4/1/16:
  - \$24,000 + \$3,000 = \$27,000.



#### Example 13 – Plan Terminates in Year 2

- The plan terminates 1/1/16.
- Assets distributed before 3/1/16
  - Liberace has not yet taken 2016 RMD.
- The RMD payable can be determined the same as prior slide under the annuity method (\$27,000).
- Alternatively can be paid using the DC Account balance Method based on the distribution on 4/1/16

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#### Example 14 – Plan Terminates in Year 2

- Lump Sum Distribution = 298,000
- Account Balance Method for RMD = 298,000 ÷ 25.6 = \$11,641
- The only time it may make sense to stay with the annuity method is when the accrued benefit is low but the lump sum distribution will include a significant amount of excess assets.



 In any of the annuity examples, if Liberace had elected his form of Annuity as an Increasing Term Certain, not a SLA, the amount of payment would have been closer to the values shown when using the DC Account Balance Method.



- Under § 415, all benefits under all forms payable at all ages are subject to 415 limitations.
- The calculations is done as of benefit commencement date.
- 415 Limitations are determined based on Limitation year



- 415 maximum benefit is the lesser of
  - IRC section 415(b)(1)(A) Dollar Limit
    - reduced for 1/10th for each YOP less than 10
  - IRC section 415(b)(1)(B) High 3 consecutive Year Average Compensation
    - Reduced by 1/10<sup>th</sup> for each YOS less than 10
- We will call this the Dollar Limit and the Comp Limit



- Includes benefits and service under all plans of a Controlled Group or an Affiliated Service Group.
- We will not get into issues with prior plans and Multiple Annuity Starting Dates (MASD).
- If you have a plan that previously sponsored a DB plan something has to be calculated and it must be reasonable.



- 415 Maximum Lump Sums (post-WRERA)
- For distributions after 12/31/08 the plan must limit lump sums to the lesser of (a), (b) and (c)
  - (a) 51/2% & Applicable Mortality
  - (b) 105% of the lump sum under 417(e) rates if not a "small" plan
  - (c) Conversion factors under the Plan
  - Watch out for conversion factors that include 417(e) rates.
- Old Law Benefits Survive



- A small plan for 415 purposes = SEP Rules = an employer that has no more than 100 employees who received compensation of at least \$5,000 in the preceding year.
- Only covering small plan rules.



- 415 Dollar Limit based on Annual benefit payable as a straight life annuity
- The Dollar limitation for a Plan Year is for the Calendar Year in which it ends, e.g. \$210,000 for the Plan Year ended 1/31/2015 through 12/31/15.
- Except any dollar limit COLA increase doesn't go into effect until the January 1st of the Calendar Year.



- The Dollar limit is *reduced* actuarially for distributions commencing at ages under 62.
- The age adjusted dollar limit is the *lesser of*:
  - Amount determined actuarially using 5% interest and the applicable mortality, or
  - Amount under Plan Factors
- Most of our small plans use actuarial assumptions to adjust the maximum dollar limit (unless the plan has early retirement factors)



- The Dollar limit is increased actuarially for distributions commencing at ages over 65.
- The age adjusted dollar limit is the *lesser of*:
  - Amount determined actuarially using 5% interest and the applicable mortality, or
  - Amount under Plan Factors
- No pre-retirement mortality to the extent forfeiture does not occur on death



- The age adjustment is not just on whole years but is on age and completed months.
- Different for age 55 and age 55 and 1 month.
- Any reasonable method can be used.
  - Age in partial months
  - Exact Age (what I use)



# Year of Participation (YOP)

- Linked to accrual computation periods.
- Employee must be a participant at least one day during the accrual computation period.
- There are differing thoughts on crediting YOP for purposes of IRC 415 if a plan is frozen.
  - To avoid the issue in an owner only plan many use a very low % of pay formula so works like a frozen plan with no increase in accruals but YOP continue to accrue



- When trying to get the largest 415 Dollar Limit
  - define mortality in the plan as the current Applicable Table.
  - For ASD before age 62 set interest no higher than 5%
  - For ASD after age 65 set interest no lower than 5%.



# Example 14 – ASD under age 62 for 2015 Plan AEQ = 5.5% / 1994 GAR <u>Age 62 Age 60</u> Plan APR's: 145.471 151.691 415 Max APR's: 156.045 162.947 Maximum Dollar Limit at 60 = lesser of:

 $210,000 \times 145.471 \div 1.055^{2} \div 151.691 =$ \$180,939.

 $210,000 \times 156.045 \div 1.05^{2} \div 162.947 =$ \$182,408



- Under above plan terms 415 Max benefit at age 60 = \$182,408
- If plan AEQ were 5% / Applicable Mortality the 415 Max benefit at age 60 = \$182,408



#### Example 15 – ASD over age 65 for 2015 Plan AEQ = 4% / 1983 IA Female <u>Age 65 Age 66</u> Plan APR's: 168.861 164.604 415 Max APR's: 145.237 141.518 Maximum Dollar Limit at 66 = lesser of: \$210,000 x 168,861 x 1.04 $\div$ 164,604 –

\$210,000 x 168.861 x 1.04 ÷ 164.604 = \$224,048

\$210,000 x 145.237 x 1.05 ÷ 141.518 = \$226,295

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- Under above plan terms 415 Max benefit at age 66 = \$224,048
- If plan AEQ were 5% / Applicable Mortality the 415 Max benefit at age 66 = \$226,295



- High 3 Year Compensation Limit
- Unrelated to the age as of the ASD.
- It's the same at age 55 as it is at age 70
- Includes compensation paid in Limitation years prior to plan entry
  - This controversy was finally put to rest with a change to the Law in PPA.



# • Year of Service (YOS)

- Must be reasonable and consistent
- Linked to accrual computation periods
- If 100 hours of service provides a whole Year of Service, then a whole YOS is earned
- No more than one YOS for each 12-month period



- For those with less than three (3) consecutive Limitation Years, the period for the average is reduced.
- Break-in-service gaps are ignored.



- Compensation for each Plan Year is limited under 401(a)(17) for the Calendar Year in which it begins.
  - \$260,000 for PY beginning in 2014,
  - \$265,000 for PY beginning in 2015.
- 415 compensation includes compensation from all related employers even when such employers don't sponsor a Plan.



- 415 LUMP SUM LIMIT EXAMPLES
- All examples assume
- Calendar plan year
- Normal Retirement = Age 62 + 5 YOP
- AEQ = 5% / current year Applicable Mortality



#### Example 16 – 415 Max LS (comp limit)

- DOB = 1/1/53
- DOH = 1/1/00
- DOP / Plan Effective = 1/1/08
- Age on 12/31/14 = 62
- YOS > 10
- YOP on 12/31/14 = 7



## Example 16 – continued

- Prior comp history:
- 2003: \$197,000 2006: \$35,000
- 2004: \$100,000 2007: \$200,000
- 2005: \$-0- 2008 and later = -0-
- High 3 Average = (\$197,000 + \$100,000 + -0-)/3 = \$99,000
- 415 Max Benefit = \$99,000



#### Example 16 – continued

- 415 LS APR (5.5%/2014 Table) @ age 62
  = 149.3252
- Maximum Dollar Limit = \$210,000 x 7/10 = \$147,000
- Maximum Compensation Limit = \$99,000 (10 YOS)
- 415 Max Lump Sum on 12/31/14 = \$99,000/12 x 149.3252 = \$1,231,993



#### Example 17 – 415 Max LS (comp limit) 1 year later

- What is 415 lump sum 1 year later?
- 415 LS APR (5.5%/2015 Table) @ age 63 = 146.359
- 415 Max Lump Sum on 12/31/15 = \$99,000/12 x 146.359 = \$1,207,462
- 415 Lump sum limit decreases with time under the Hi 3 Comp Limit Calculations



#### Example 18 – 415 Max LS (dollar limit)

- Same facts as before except the Hi 3 Avg = \$255,000
- 415 Maximum Benefit = 210,000 x 7/10 = \$147,000
- 415 Max LS on 12/31/14 = 147,000/12 \* 149.3252 = \$1,829,233



#### Example 19 – 415 Max LS (dollar limit) 1 year later

- What is 415 lump sum 1 year later?
- YOP = 8
- 415 Maximum Benefit = 210,000 x 8/10 = \$168,000
- 415 Max Lump Sum on 12/31/15 = \$168,000/12 x 146.359 = \$2,049,026



 For participants in between age 67-68 with 10 YOS/YOP, the 415 lump sum limit will change from the Dollar Limit to the Comp Limit and the descent will begin.



#### 415 Dollar vs High 3 Comp Limits High 3 Adjusted Dollar\* Comp\* Age Year \$243,993 2014 \$255,000 67 \$260,000 \$263,433 2015 68 \$284,832 \$263,333 2016 69

\*Based on known limits through 2015





# THANK YOU!

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