EAR

ENROLLED ACTUARIES REPORT

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The 2008 Gray Book

LIKE MANY GRAY BOOKS, the 2008 edition is a Pandora's box of guidance. A Q-and-A compilation developed after the annual meeting of the Treasury Department, the Internal Revenue Service (IRS), and the Enrolled Actuaries Joint Program Committee, the responses aren't official positions and reflect only the personal views of the government employees. At times, it even appears to contradict prior Gray Book pronouncements. It's quite dense and will reward careful study with a glimpse of the mental scaffolding the IRS is gradually erecting around the Pension Protection Act (PPA). However, since the aftermath of PPA's passage left pension regulators scrambling to play catch-up and pension practitioners scratching their heads wondering just what it all meant, this year's Gray Book is perhaps the best resource currently available for penetrating the murky waters of the enigmatic act.

The book is especially helpful regarding the issues created by the new Internal Revenue Code (IRC) Section 436, which restricts when benefits can be paid, when amendments can take effect, and even whether participants may accrue benefits. Eleven of the 48 questions included in the 2008 Gray Book deal with that section.

For instance, Question 19 asks whether mandatory lump sums (under $5,000) could be paid even though other lump sums would be considered "prohibited payments." The IRS may want to be able to answer "yes" to this question, but the best it could offer was a hope that the technical bill pending in Congress would permit it.

Question 21 is a frightening question, with a frightening answer. We have known for some time that the IRS considers changes in the 415 limit to be a plan amendment—because amortization bases should theoretically be established whenever an increase in the limit results in an increase in a participant's accrued benefit, and it's amortized over a much longer period than ordinary gains and losses. As a practical matter, many large-plan actuaries lump this in with their experience gains instead. (This won't matter in the future, due to the demise of Section 412.)

In order to alleviate the nuisance of annually amending the plan to provide for that year's 415 increase, most plans "track" the change automatically. In doing so, it's easy to forget that the IRS considers each such change as a plan amendment. It's hard to agree that it's an "amendment" as discussed in the PPA, since the clear language of the plan already provides for such increases to be recognized when they are made. The answer to that question makes it clear that if a plan has an adjusted funding target attainment percent-

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age (AFTAP) of less than 80 percent, that year's increase in the 415 benefit can't be taken into account when determining the accrued benefit of any participant. "The increase in the limit is deferred until such time as the plan is sufficiently well-funded to allow it to take effect," the Gray Book says.

The same is true of an increase in the 401(a)(17) limit, namely that it is a plan amendment. In this case, however, since it doesn't create an increase in accrued benefits, it would not be a prohibited amendment, even if the plan's AFTAP is less than 80 percent. In this case, the IRS notes that "the amount of the Section 436 contribution that would be required for the amendment to take effect is zero." In other words, a zero contribution has to be made before the 401(a)(17) compensation increase can be effective. (One wonders whether we need a cancelled check in case of an audit.)

The meat and potatoes of the rest of the Section 436-related questions all pertain to how to handle our new responsibilities as enrolled actuaries to issue AFTAP certifications by April 1 of every year (for calendar-year plans), or at the latest, by Oct. 1. Unfortunately, the 2008 Gray Book was not widely available until after April 1.

Section 436 makes it clear that unless an enrolled actuary certifies to an AFTAP by the first day of the fourth month, then the AFTAP is presumed to be 10 percent less than the prior year's AFTAP. What is less clear is just what this means—what such a certification must include to be valid and how to determine the AFTAP itself, on which the certificate is based.

Several of the questions in the Gray Book make it clear that we are allowed to use estimates for the components of the AFTAP—namely the funding target, the actuarial value of assets, and the carryover balance (which used to be called the credit balance). This is demonstrated by Questions 22 and 24, in which the plan's actuary estimates valuation results and then issues a "range certification" that the AFTAP is "80 percent or more."

Fortunately, the IRS has smiled upon us and given us the benevolent invention of a "range certification." By closely reading the assumed facts under Question 22, the math doesn't even have to work out for us to issue such a range certification. In this question, the estimated AFTAP would come out to 79 percent, but "based on this estimate, the actuary is confident that the final 2009 valuation results will show assets of at least 80 percent of the funding target." This question is well worth reading to get an idea of the leeway we have under this slippery concept of a range certification.

The answer to Question 24 was equally surprising. Here, the sponsor puts in an additional contribution toward the prior plan year, before April 1, 2009, but the actuary discovers later that "due to an unexpected experience loss," the AFTAP would be 79 percent, not 80 percent, as expected. The actuary discovers this fact in July but waits until Oct. 1, 2009 (after the plan sponsor has made a second additional contribution toward 2008, in an amount sufficient to bring the assets up to the level needed to reach 80 percent), to make a final AFTAP certification. The IRS response indicated this wouldn't even be a "material change" and the plan would avoid benefit restrictions for 2009. This question raises the specter of "What did the actuary know, and when did he or she know it?" as well as many ethical issues about the possibilities of gaming the system.

While all the Gray Book questions are worth reading (if too numerous to discuss), my favorite question was Question 42, which asks what constitutes a prohibited reduction in a participant's accrued benefit. If a benefit goes down due to an increase in a Social Security offset, is this acceptable?

In the 1992 Gray Book, Question 25, the response to this question was that "even if an amendment is not involved, a plan provision that would have the effect of allowing accrued benefits to reduce would be in violation of 411(b)(1)(G), whether a plan is…a [primary insurance amount] offset plan or other type of defined benefit plan."

This year, the IRS opined that an accrued benefit could decrease during continued employment due to increases in a Social Security offset "to the extent the offset meets the restriction specified in Rev. Rule 84-45 and is in keeping with the qualification rule stated in IRC 410(a)(15)."

As Gray Book session presenter Don Segal said, "That's why they call it the Gray Book!"

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