

# Memorandum

Date: July 19, 2007  
From: Funding Reform Advisory Task Force  
To: W. Thomas Reeder, Harlan Weller, David Gustafson, Martin Pippins,  
James E. Holland, Jr.  
Subject: **Applicability of PPA Lump Sum Assumptions in Standard Terminations**

Section 302 of the Pension Protection Act of 2006 (PPA) changes the interest rate and mortality table used in calculating minimum values of certain benefit forms, including lump sum distributions. These changes apply “with respect to plan years beginning after December 31, 2007” (PPA Section 302(c)). The focus of this memorandum is on the need for guidance on the applicability of these changes to plans that are undergoing standard terminations and from which post-2007 lump sum distributions will be made.

## **PPA Changes to Minimum Lump Sum Assumptions**

In brief, the PPA changes to the rules governing minimum lump sums call for use of: (1) the first, second, and third segment rates as applied under the funding rules, with certain adjustments, for the month before the date of distribution or such other time as prescribed by Treasury regulations; and (2) a mortality table that is based on the mortality table required for minimum funding purposes under PPA, subject to certain modifications by the Secretary of the Treasury. Under a transition rule, the interest rate changes are phased in for the 2008 through 2011 plan years, with a 20% weighting of the new PPA interest rate for 2008, 40% for 2009, 60% for 2010, and 80% for 2011. The PPA changes to the mortality table, however, are not subject to such a phase-in and are thus fully effective beginning with the 2008 plan year.

## **Effect on Lump Sum Values**

For most participants, the PPA minimum lump sum value will be lower than the pre-PPA minimum lump sum value (which requires use of 30-year Treasuries and the mortality table in Rev. Rul. 2001-62), although older participants could have a slightly higher lump sum value. The likelihood that the PPA lump sum value would be higher for particular participants is greatest early in the transition period because the mortality table change (which serves to increase values) is fully effective, while the interest rate change (which serves to decrease values) is only partially effective. However, for all post-2007 plan years, the PPA-based minimum lump sum value could be either higher or lower than the pre-PPA-based minimum lump sum value for particular participants.

Under PPA Section 1107, an amendment to implement the PPA minimum lump sum value changes may be adopted (for a non-governmental plan) as late as the end of the 2009 plan year and generally may be given retroactive effect without violating the anticutback rule.

## **Applicability to Plans Undergoing Standard Terminations**

In the context of a plan undergoing a standard termination, it is not clear how (if at all) these changes would apply to post-2007 distributions if the plan has a pre-2008 termination date, nor is it clear how the 2008–2011 transition rule would apply to distributions during or after a transition plan year where the plan’s termination date falls during a transition plan year. A fundamental

threshold issue is whether the legal framework governing minimum lump sum values is determined based on the time of distribution (as is the case with the variable interest rate ordinarily used to determine the minimum value) or instead as of the plan termination date.

It is important that guidance be issued on these issues quickly because many plans are currently undergoing, or are planning shortly to initiate, standard terminations in which lump sum benefits will be paid after the 2007 plan year.

### **Specific Guidance Needs**

It would be helpful if the requested guidance were to address as many of the following questions as possible. In all cases, assume that the plan is undergoing a standard termination, is maintained on a calendar-year basis, and in its pre-PPA form provides for lump sums to be determined based on their minimum required values.

- (1) If a plan is amended before its *pre-2008* termination date (and possibly before a standard termination is contemplated) to explicitly incorporate the PPA lump sum interest and mortality assumptions so that, as of the termination date, the plan provides that: (1) pre-2008 distributions will be based on pre-PPA minimum lump sum values; and (2) post-2007 distributions will be based on PPA minimum lump sum values (subject to the 2008–2011 transition rule):
  - (a) Would lump sums distributed in 2008, during the permitted distribution period in the standard termination under Title IV, be based on the pre-PPA assumptions, the post-PPA assumptions, or on whichever provides the greater lump sum?
  - (b) If the plan provides for a lump sum option not only upon plan termination, but also at a later time (*e.g.*, at retirement), would the later lump sum option that must be preserved in an irrevocable commitment (*e.g.*, when a particular participant reaches retirement age in 2025) be based on the pre-PPA assumptions, the post-PPA assumptions, or on whichever provides the greater lump sum?
- (2) What would the answers be to questions (1)(a) and (1)(b) if one assumes the same facts as in question (1), except that:
  - (a) the amendment provides for use of the “applicable interest rate” and “applicable mortality table” under IRC § 417(e) without further specifying either one; OR
  - (b) the plan is *not* amended to reflect the PPA changes to lump sum assumptions because the pre-PPA version of the plan provides for use of the “applicable interest rate” and “applicable mortality table” under IRC § 417(e) without further specifying either one; OR
  - (c) the plan has not been amended on or before the termination date to reflect the PPA changes to lump sum assumptions, but is so amended thereafter, where the pre-PPA version of the plan—
    - (i) provides explicitly for use of specified pre-PPA assumptions for both interest and mortality; OR
    - (ii) provides explicitly for use of specified pre-PPA assumptions for interest (*i.e.*, 30-year Treasuries) but refers only to the “applicable mortality table” for mortality; OR

- (iii) provides explicitly for use of specified pre-PPA assumptions for mortality (*i.e.*, the mortality table in Rev. Rul. 2001-62) but refers only to the “applicable interest rate” for interest?
- (3) Where a plan undergoing a standard termination with a pre-2008 termination date has not been amended on or before the termination date to reflect the PPA changes to lump sum assumptions, under what circumstances (if any) would IRS permit or require the plan to be so amended as part of the determination letter process?
- (4) If a plan is amended before its 2008 termination date to explicitly incorporate the PPA lump sum interest and mortality assumptions so that, as of the termination date, the plan provides that lump sum distributions will be based on PPA mortality and a 20% phase-in of the PPA interest rates for 2008 distributions, a 40% phase-in for 2009 distributions, and so on:
- (a) Would lump sums distributed in 2009, during the permitted distribution period in the standard termination under Title IV, be based on the 20% or the 40% phase-in of the PPA interest rate changes?
- (b) If the plan provides for a lump sum option not only upon plan termination, but also at a later time (*e.g.*, at retirement), would the later lump sum option that must be preserved in an irrevocable commitment (*e.g.*, when a particular participant reaches retirement age in 2025) be based on the 20% or the full phase-in of the PPA interest rate changes?
- (5) Assume the same facts as in question (4) (involving a 2008 termination date), except that the amendment provides for use of the “applicable interest rate” and “applicable mortality table” under IRC § 417(e) without further specifying either one. What would the answers then be to questions (4)(a) and (4)(b)?
- (6) Assume the same facts as in question (4) (involving a 2008 termination date), except that the plan did not need to be (and therefore was not) amended to reflect the PPA changes to lump sum assumptions because the pre-PPA version of the plan provides for use of the “applicable interest rate” and “applicable mortality table” under IRC § 417(e) without further specifying either one. What would the answers then be to questions (4)(a) and (4)(b)?
- (7) Assume that a plan, as a means of distributing benefit liabilities in a pre-PPA or post-PPA standard termination, has purchased from an insurer an irrevocable commitment that (at the time of its purchase) did not (and under applicable law was not required to) reflect the PPA changes to lump sum assumptions. Under what circumstances, if any, would the insurer be permitted or required to reflect the PPA lump sum assumptions when paying lump sums under the irrevocable commitment? (Similar questions arise in the context of ongoing plans that have purchased irrevocable commitments, but the focus of this memorandum is on plans undergoing standard terminations.)