PRESENT LAW AND BACKGROUND RELATING TO QUALIFIED DEFINED BENEFIT PLANS

Scheduled for a Public Hearing
Before the
HOUSE COMMITTEE ON WAYS AND MEANS
SUBCOMMITTEE ON SELECT REVENUE MEASURES
on September 17, 2014

Prepared by the Staff
of the
JOINT COMMITTEE ON TAXATION

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INTRODUCTION AND SUMMARY

The Subcommittee on Select Revenue Measures of the Committee on Ways and Means of the House of Representatives has scheduled a public hearing on September 17, 2014, on defined benefit plans offered by private-sector employers, including both multiemployer plans and single-employer plans. This document,[1] prepared by the staff of the Joint Committee on Taxation, provides a description of present law and data relating to retirement plans generally and to defined benefit plans in particular.

Present Law

Tax-Favored Retirement Savings

In general

The Internal Revenue Code provides two general vehicles for tax-favored retirement savings: individual retirement arrangements (IRAs) and employer-sponsored retirement plans.

Tax-favored treatment for these vehicles generally consists of pretax treatment of contributions, tax-exempt status of the trust or account holding assets, and income inclusion by an individual only at the time of distribution, with the option of deferring income inclusion by rolling the distribution over to another tax-favored retirement vehicle. Any after-tax contributions, including Roth contributions, result in basis, which reduces the amount of a distribution included in income. Certain distributions from Roth arrangements are fully excluded from income. A taxpayer with adjusted gross income below certain thresholds may receive a nonrefundable tax credit of up to 50 percent of the taxpayer's contributions up to $2,000.

Individual retirement arrangements (IRAs)

There are two basic types of IRAs: traditional IRAs, to which deductible or nondeductible contributions can be made, and Roth IRAs, contributions to which are not deductible. Individuals may make total IRA contributions of up to $5,500 for 2014 (plus $1,000 if at least age 50), but some individuals with adjusted gross income above certain levels may not make deductible contributions to a traditional IRA or contributions to a Roth IRA

Tax-favored employer-sponsored plans

Whether to offer a tax-favored retirement plan is a voluntary choice by an employer, with various factors entering into the decision. The Code provides for multiple types of tax-favored employer-sponsored retirement plans, including qualified retirement plans and annuities, tax-deferred annuities, governmental eligible deferred compensation plans, SIMPLE (savings incentive match plan for employees) IRAs, and simplified employee pensions (SEPs). These

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[1] This document may be cited as follows: *Joint Committee on Taxation, Present Law and Background Relating to Qualified Defined Benefit Plans* (JCX-99-14), September 15, 2014. This document is available at www.jct.gov.

plans afford employers flexibility in the design and structure of the retirement plans they adopt, subject to the requirements applicable to each type of plan under the Code and, in some cases, under the Employee Retirement Income Security Act of 1974.

Qualified retirement plans and annuities

A plan of deferred compensation that meets the qualification requirements under the Code (a "qualified retirement plan") is accorded tax-favored treatment as described above, as well as a current deduction for an employer's contributions. Some requirements applicable to qualified retirement plans define participant rights and provide participant protections and generally have parallels under ERISA, which is within the jurisdiction of the Department of Labor (DOL). Some Code requirements limit tax benefits; some are aimed at providing retirement security for both lower-paid and higher-paid employees. A qualified annuity plan is similar to a qualified retirement plan, but plan assets are invested in annuity contracts rather than a trust or custodial account.

Enforcement of a qualified retirement plan requirement depends on the source of the requirement. Failure to meet a qualification requirement may mean the loss of tax-favored status; certain Code requirements are enforced through an excise tax. Under administrative programs established by the Internal Revenue Service ("IRS"), employers and service providers can obtain advance IRS approval of qualified retirement plan documents. As an alternative to plan disqualification, the consequences of which would fall most heavily on plan participants, the IRS has established the Employee Plans Compliance Resolution System, which permits employers to correct qualification compliance failures and continue to provide their employees with retirement benefits on a tax-favored basis. ERISA requirements are generally enforced by DOL or participant suit.

Qualified retirement plans are of two general types: defined contribution plans, under which benefits are based on a separate account for each participant, to which are allocated contributions, earnings and losses; and defined benefit plans, under which benefits are determined under a plan formula and paid from general plan assets, rather than individual accounts. Some qualified retirement plans are referred to as hybrid plans because they have features of both a defined benefit plan and a defined contribution plan; for example, cash balance plans are defined benefit plans, but plan benefits are defined by reference to a hypothetical account balance.

Qualified retirement plans are also categorized by the number of employers that maintain the plan and the type of employees covered by the plan. A single-employer plan is a plan maintained by one employer (treating members of controlled groups and affiliated service groups as one employer) and may cover collectively bargained employees (employees covered by a collective bargaining agreement), noncollectively bargained employees or both. A multiple-employer plan is a single plan in which two or more unrelated employers (not members of the same controlled group or affiliated service group) participate. Some qualification requirements apply to a multiple-employer plan on a plan-wide basis; others apply on an employer-by-employer basis. Multiemployer plans (also known as "Taft-Hartley" plans) are maintained pursuant to one or more collective bargaining agreements with two or more unrelated employers; the collective bargaining agreements require the employers to contribute to the plan.

Defined contribution plans may provide for nonelective contributions and matching contributions by employers and pretax or after-tax contributions by employees, generally subject to a limit of the lesser of $52,000 (for 2014) or the employee's compensation. Defined contribution plans may themselves be of different types (profit-sharing plans, stock bonus plans, or money purchase plans) and may include special features, such as a qualified cash or deferred arrangement (a section 401(k) plan) or an employee stock ownership plan (ESOP). Defined contribution plans often provide for loans to participants, and, besides distributions on severance from employment (a lump sum or installments), may provide for in-service distributions.

For qualified retirement plan purposes, self-employed individuals (sole proprietors and partners) are treated as employees of the businesses they own. Although the qualified retirement plan rules generally apply to self-employed individuals in the same manner as to employees, special rules apply in determining the compensation of a self-employed individual and the self-employed individual's deduction for plan contributions.

Top-heavy rules apply to limit the extent to which accumulated benefits or account balances under a qualified retirement plan can be concentrated for key employees, which include certain business owners and officers with compensation above a certain level. If a plan is top-heavy, minimum contributions or benefits for nonkey employees and, in some cases, faster vesting is required.

A small employer that adopts a new qualified retirement plan may receive a nonrefundable income tax credit for related expenses. The credit is the lesser of $500 per year or 50 percent of qualified expenses and applies for up to three years.

Defined Benefit Plans

Overview

Benefits under a defined benefit plan are often determined under a plan formula that generally takes into account compensation and service, referred to as a traditional defined benefit plan. However, hybrid defined benefit plans, such as cash balance plans, under which a participant's benefit is expressed as a hypothetical account balance, are also common. The employer generally determines the benefit formula under a defined benefit plan, and benefits vary among plans.

Defined benefit plans are generally funded by employer contributions. Private defined benefit plans are subject to minimum funding requirements, and benefits under most private plans are guaranteed, within limits, by the Pension Benefit Guaranty Corporation (PBGC).

Defined benefit plans are generally subject to the same qualification requirements as defined contribution plans, though some requirements apply to the two types of plans differently. Defined benefit plans are also subject to some requirements that do not apply to defined contribution plans.

Common defined benefit plan designs

Traditional defined benefit plans under which benefits are based on compensation and service include final average pay plans (which may use a unit credit or flat benefit formula) and career average pay plans. Some plan formulas are designed to reflect the fact that Social Security taxes paid by an employer, and Social Security benefits, are based on an employee's compensation only up to the wage base, referred to as Social Security integration.

Flat dollar plans provide a specified dollar amount of annuity benefit at retirement for each year of service, regardless of the particular participant's compensation. Cash balance plans base benefits on a hypothetical account maintained for a participant, to which hypothetical allocations and earnings are credited. Under a pension equity plan, an employee's hypothetical account is generally determined by reference to final average pay and years of service.

Some defined benefit plans provide for employee contributions, referred to as contributory defined benefit plans. Some defined benefit plans provide for post-retirement benefit increases based on cost-of-living adjustments. An insurance contract plan is a type of defined benefit plan that is funded exclusively by the purchase of individual insurance contracts (or in some cases, group insurance contracts) and meets certain other requirements.

Selected Qualification Requirements for Defined Benefit Plans

Vesting, accrual and anti-cutback rules

In the case of a defined benefit plan, a participant's accrued benefit is the portion of the normal retirement benefit (that is, the annuity payable at normal retirement age under the plan's benefit formula) that has accrued under the accrual method provided under the plan. A participant must be vested at all times in the portion of the accrued benefit under a defined benefit plan attributable to his or her own contributions, if any. With respect to the employer-provided portion of the accrued benefit under a defined benefit plan using a traditional benefit formula, minimum vesting must occur under one of two vesting schedules: 100 percent vesting after five years of service, or 20 percent, 40 percent, 60 percent, 80 percent, and 100 percent, respectively, over the period of three to seven years of service. Under a hybrid plan, full vesting must occur after three years of service. Full vesting must also occur at normal retirement age and, generally, on plan termination.

Under the accrual (or anti-backloading) rules, benefits must accrue in one of three permissible patterns over a participant's period of service in order to prevent significant accruals to be delayed until later years of service. Reductions in an employee's rate of accrual due to increasing age generally are prohibited.

Various forms of benefits under a defined benefit plan (referred to as optional forms of benefit) must generally be actuarially equivalent to the normal retirement benefit or may be provided on an actuarially subsidized basis. Lump-sum benefits must be no less than the amount determined using certain specified interest and mortality assumptions.

Under the anti-cutback rules, a plan amendment generally may not reduce accrued benefits or reduce or eliminate an optional form of benefit, early retirement benefit or retirement-type subsidy with respect to accrued benefits. Amendments are generally permitted only to reduce future rates of accrual, or eliminate optional forms of benefits or eliminate or reduce early retirement benefits or retirement-type subsidies only with respect to future accruals, and, in those cases, notice must be provided.

QJSA and QPSA requirements

Spousal protections applicable to defined benefit plans generally require that benefits be paid in the form of a qualified joint and survivor annuity (QJSA) unless the participant elects a different form of distribution and the participant's spouse consents to the election. A QJSA is generally a life annuity for the participant with an annuity of at least 50 percent of the participant's annuity amount payable to the surviving spouse after the participant's death. Other forms of benefit offered to a married participant may not be actuarially more valuable than the QJSA. If a married participant dies before benefits begin, the plan must offer a survivor benefit for the spouse in the form of a qualified preretirement survivor annuity (QPSA), which is a survivor annuity for the spouse that is at least 50 percent of the employee's accrued benefit.

Restrictions on in-service distributions and phased retirement

Defined benefit plans must provide benefits in the form of an annuity. In addition, a defined benefit plan generally cannot make in-service distributions before the earliest of normal retirement age, age 62, or plan termination. Under Treasury regulations, the normal retirement age under a plan must be an age that is not earlier than the earliest age that is reasonably representative of the typical retirement age for the industry in which the covered workforce is employed.

Benefit limits applicable to defined benefit plans

Under the Code, annuity distributions from a defined benefit plan for a year generally cannot exceed the lesser of $210,000 (for 2014) or the employee's high-three-year average compensation. The dollar limit is generally reduced if distributions begin before age 62 and increased if distributions begin after age 65, and an actuarially adjusted limit applies to benefits paid in other forms, such as lump sums.

Nondiscrimination Requirements

A qualified retirement plan, including a defined benefit plan, is prohibited from discriminating in favor of highly compensated employees, referred to as the nondiscrimination requirements. Nondiscrimination requirements include the minimum coverage requirement, under which the group of employees covered by a plan must be a nondiscriminatory mix of highly and nonhighly compensated employees. Under the general nondiscrimination requirements, the amount of contributions or benefits provided under the plan must be nondiscriminatory; each benefit, right or feature under the plan must be available to a nondiscriminatory group; and the timing of plan amendments must be nondiscriminatory.

Three general approaches are available for testing the amount of benefits under a defined benefit plan: (1) design-based safe harbors under which the plan's benefit formula satisfies certain uniformity standards, (2) a general test, and (3) cross-testing of equivalent allocations.

Subject to certain threshold requirements, a defined benefit plan may be aggregated with a defined contribution plan, and the general nondiscrimination test may be applied to the combination of benefits under the defined benefit plan and an amount of equivalent benefits under the defined contribution plan, as determined under the cross-testing rules. This testing method may be needed in the case of a defined benefit plan closed to new entrants, but, subject to temporary IRS relief, is not available if none of the threshold conditions is met.

Funding and Deduction Rules for Defined Benefit Plans

In general

Employer contributions to a defined benefit plan are generally subject to minimum funding requirements, the details of which depend on whether the plan is a single-employer plan or a multiemployer plan. Unless a funding waiver is obtained, an employer may be subject to a two-tier excise tax if the funding requirements are not met. The annual deduction limit applicable to employer contributions to a defined benefit plan for a year also depends on whether the plan is a single-employer plan or a multiemployer plan. If contributions exceed the amount deductible, an employer is generally subject to an excise tax.

Subject to various conditions, before January 1, 2022, excess assets in a defined benefit plan may be transferred to separate accounts within the plan to fund retiree health benefits or group term life insurance benefits. Defined benefit plan assets generally may revert to an employer only after termination of the plan and satisfaction of all plan liabilities. Assets that revert to an employer on plan termination are includible in the employer's gross income and subject to an excise tax.

Single-employer plans

The minimum required contribution for a single-employer defined benefit plan generally consists of (1) a portion of the plan's funding target (the present value of all benefits accrued or earned as of the beginning of the plan year) and (2) the plan's target normal cost (the present value of benefits expected to accrue or to be earned during the plan year plus administrative expenses). Required contributions with respect to the plan's funding target consist of installments needed to fund the portion of the funding target exceeding the value of plan assets.

Under the single-employer plan funding rules, present value is generally determined using three interest rates ("segment" rates), each of which applies to benefits expected to be paid from the plan during a certain period and is based on a corresponding portion of a corporate bond yield curve that reflects average rates for a preceding 24-month period. For plan years beginning after December 31, 2011, a segment rate may be adjusted if needed to come within a specified range of average segment rates for the preceding 25-year period. As an alternative to segment rates, interest rates on a monthly corporate bond yield curve may be used.

In general, mortality tables specified by the IRS apply in determining present value, which are based on the actual experience of pension plans and projected trends in such experience, taking into account results of available independent studies of mortality of individuals covered by pension plans. The IRS is required (at least every 10 years) to revise any table in effect to reflect the actual experience of pension plans and projected trends in such experience. Currently applicable tables are based on the RP-2000 Mortality Tables Report, issued by the Society of Actuaries in July 2000. In guidance issued last year, the IRS and Treasury referenced the Mortality Improvement Scale BB Report, issued by the Society of Actuaries in September 2012, and requested comments as to whether other studies of actual mortality experience of pension plans and projected trends of that experience are available that should be considered for use in developing mortality tables for future use under the funding rules.

If a defined benefit plan is funded below certain levels, "at-risk" status and special assumptions apply in determining the plan's funding target and target normal cost. In applying the funding rules, the value of plan assets generally is the fair market value of the assets, but, subject to certain conditions and limits, value can be based on the average value over a two-year period.

If a single-employer plan is funded below certain levels, restrictions on benefit increases, certain types of benefits, and benefit accruals may apply.

Employer efforts to manage benefit liabilities under single-employer defined benefit plans have included closing a defined benefit plan to new entrants or ceasing accruals altogether, aligning plan investments with liabilities, and distributing annuity contracts or lump-sums to retirees in satisfaction of plan obligations.

Multiemployer plans

General funding requirements apply to all multiemployer plans. In addition, additional funding requirements apply to a plan that is in reorganization status or is insolvent and to plans in endangered or critical status. An employer that withdraws from a multiemployer plan is generally liable to the plan for a portion of the plan's unfunded vested benefits, referred to as withdrawal liability. Various provisions limit the amount of an employer's withdrawal liability.

Under the general funding requirements, a multiemployer defined benefit plan maintains a funding standard account, to which charges (such as for benefit accruals and negative plan experience) and credits (such as for positive plan experience and contributions) are made. The minimum required contribution for a plan year is the amount, if any, needed to balance accumulated credits and accumulated charges to the funding standard account. If required contributions are not made, so the funding standard account has a negative balance, an accumulated funding deficiency results.

A multiemployer plan is required to use an acceptable actuarial cost method (referred to as the plan's funding method) to determine the elements included in its funding standard account for a year, including normal cost and supplemental cost. Normal cost generally represents the cost of future benefits allocated to the year under the plan's funding method. The supplemental cost for a plan year is the cost of future benefits that would not be met by future normal costs, future employee contributions, or plan assets. Supplemental costs may be attributable to past service liability or to worse than expected plan experience. Supplemental costs are amortized (that is, recognized for funding purposes) over a specified number of years (generally 15 years) by annual charges to the funding standard account over that period. Factors that result in a supplemental loss can alternatively result in a gain that is recognized by annual credits to the funding standard account over a 15-year amortization period (in addition to a credit for contributions made for the plan year).

Actuarial assumptions used under the multiemployer plan funding rules must be reasonable. The interest rate used in funding computations, which represents the expected return on plan assets over time, and mortality assumptions used are subject to these general standards; the funding rules do not specify the interest rate or mortality tables that must be used. For funding purposes, the actuarial value of plan assets may be used, rather than fair market value, subject to certain conditions.

Additional contributions are required for multiemployer plans that experience financial difficulties, referred to as reorganization status. Subject to certain requirements, a multiemployer plan in reorganization status may also be amended to reduce or eliminate accrued benefits in excess of the amount of benefits guaranteed by the PBGC, notwithstanding the anti-cutback rules. Active and inactive participants must generally be treated similarly with respect to benefit reductions made under a plan in reorganization status.

In general, a multiemployer plan is insolvent when its available resources in a plan year are not sufficient to pay the plan benefits for that plan year. Notwithstanding the anti-cutback rules, an insolvent plan is required to reduce benefits to the level that can be covered by the plan's assets, but not below the level guaranteed by the PBGC. If needed for an insolvent plan to pay benefits at the guarantee level, the PBGC provides financial assistance to the plan.

Additional funding rules apply to a multiemployer defined benefit pension plan that is in endangered or critical status. These rules require the adoption of and compliance with: (1) a funding improvement plan in the case of a multiemployer plan in endangered status; and (2) a rehabilitation plan in the case of a multiemployer plan in critical status. In the case of a plan in critical status, additional required contributions apply, certain benefit reductions are permitted, and employers are relieved of liability for minimum required contributions under the otherwise applicable funding rules, provided that a rehabilitation plan is adopted and followed. The endangered and critical rules generally do not apply for plan years beginning after December 31, 2014, except for certain plans already in endangered or critical status.

Although many multiemployer defined benefit plans are not experiencing funding problems, some are already insolvent and receiving financial assistance from the PBGC or are likely to become insolvent in the near term. The PBGC projects that assets associated with its multiemployer program are more likely than not to be exhausted by the end of 2022.

Some have proposed changes to the multiemployer rules that would give plan sponsors greater authority to reduce protected benefits, within limits, before plan insolvency. Others believe that expanding plan sponsors' authority to reduce benefits should be a last resort, only after all alternatives approaches have been explored.

Pension Benefit Guaranty Corporation

The PBGC, a corporation within DOL, provides an insurance program for benefits under most defined benefit plans maintained by private employers. The PBGC is administered by a director. Its board of directors consists of the Secretary of the Treasury, the Secretary of Labor, and the Secretary of Commerce.

The PBGC is financed through the payment of premiums by covered defined benefit plans, assets from terminated single-employer defined benefit plans trusteed by the PBGC, and investment income on PBGC assets. The PBGC insures pension benefits under separate programs for single-employer and multiemployer defined benefit plans.

In the case of a single-employer defined benefit plan, flat-rate premiums apply for 2014 at a rate of $49 per participant. If a single-employer defined benefit plan has unfunded vested benefits, variable-rate premiums also apply for 2014 at a rate of $14 per $1,000 of unfunded vested benefits divided by the number of participants, subject to a cap of $412 per participant for 2014.

An employer may voluntarily terminate a single-employer plan in a standard termination, which requires all benefits under the plan to be vested and funding of the plan at a level sufficient to pay all benefits. Assets remaining after all benefits are paid may revert to the employer. Alternatively, an employer in bankruptcy may voluntarily terminate an underfunded single-employer plan in a distress termination, in which case the PBGC takes over plan assets and benefit obligations. In certain circumstances, the PBGC may terminate a plan in an involuntary termination. When an underfunded single-employer plan terminates, the PBGC benefit guarantee limit is generally a dollar amount applicable for the year of plan termination ($59,320 for 2014) for annuity benefits commencing at age 65, with a reduced or increased limit for earlier or later commencement.

In the case of a multiemployer plan, flat-rate premiums apply at a rate of $12 per participant for 2014. The PBGC provides financial assistance to insolvent multiemployer plans in the amount needed to pay benefits at the guarantee limit, which is the sum of 100 percent of the first $11 of monthly benefits plus 75 percent of the next $33 of monthly benefits for each year of service.

Data Relating to Retirement Plans

General Data on Retirement Plan Participation

Data show that, in 2014, 65 percent of U.S. workers employed in the private sector had access to a qualified retirement plan and 48 percent of workers employed in the private sector participated in a qualified retirement plan. This translates to a take-up rate of 75 percent, meaning 75 percent of those with access participated. Over the period 1975-2011, the number of participants in private single-employer defined contribution plans has steadily increased while participation in private single-employer defined benefit plans and multiemployer defined contribution and defined benefit plans has remained steady. Among private defined benefit plan participants, a steadily decreasing portion consists of active participants and a steadily increasing portion consists of inactives. Within the private sector, rates of access to and participation in qualified retirement plans vary between full-time and part-time workers and between union and non-union workers. Rates of access to and participation in qualified retirement plans also vary between workers in the private sector and in State and local government.

Data show that married households are more likely to have savings in tax-favored retirement arrangements than single households. Older households are more likely than younger households to have defined benefit plan pensions and younger households are more likely than older to have defined contribution plan accounts.

Data on Retirement Plan Assets

In 2013, assets in private defined benefit plans totaled about $3.1 trillion; assets in private defined contribution plans totaled about $4.9 trillion; and assets in IRAs totaled about $6.5 trillion. The investment composition of total assets held in private defined benefit plans, private defined contribution plans and IRAs varies among the types of arrangements.

Data on Funded Status of Defined Benefit Plans and Status of PBGC Programs

Single-employer plans covered by the PBGC insurance program

As of 2013, 23,399 defined benefit plans were insured under the PBGC single-employer program with a total of 31.9 million participants. The aggregate funded status of these plans was 85 percent, with total plan assets of about $2 trillion and liabilities of about $2.4 trillion. Among underfunded single-employer plans, the 50 plans with the highest levels of underfunding accounted for about 32 percent of the total underfunding (about $127 billion in underfunding). According to the PBGC 2013 Annual Report, as of September 30, 2013, the single-employer plan insurance program had total assets of about $83 billion and total liabilities of about $110.6 billion (including an amount attributable to claims for probable future terminations of underfunded single-employer plans), for a net negative position of about $27.4 billion.

Multiemployer plans

As of 2013, 1,435 defined benefit plans were insured under the PBGC multiemployer program with a total of about 10.4 million participants. The aggregate funded status of these plans was 50 percent, with total plan assets of about $400 billion and liabilities of about $800 billion. Among underfunded multiemployer plans, the 50 plans with the highest levels of underfunding accounted for about 54 percent of the total underfunding (about $217 billion in underfunding). According to the PBGC 2013 Annual Report, as of September 30, 2013, the multiemployer plan insurance program had total assets of about $1.7 billion and total liabilities of about $10 billion (including the present value of future nonrecoverable financial assistance provided to multiemployer plans), for a net negative position of about $8.3 billion.

I. PRESENT LAW

A. Tax-Favored Retirement Savings[2]

1. In general

The Internal Revenue Code ("Code")[3] provides two general vehicles for tax-favored retirement savings: individual retirement arrangements ("IRAs") and employer-sponsored retirement plans.

Tax-favored treatment for these vehicles generally consists of pretax treatment of contributions (that is, contributions are either excluded from income or deductible),[4] tax-exempt status of the trust or account holding assets, and income inclusion by an individual only at the time of distribution, with the option of deferring income inclusion by rolling the distribution over to another tax-favored retirement vehicle.[5] To the extent contributions are made on an after-tax basis, the contributions result in basis, which reduces the amount included in income at the time of distribution. In the case of a Roth IRA or Roth contributions made to an employer-sponsored plan, contributions are always made on an after-tax basis, and certain distributions are fully excluded from income.

A taxpayer with adjusted gross income below certain thresholds who contributes to an IRA or an employer-sponsored retirement plan is generally eligible for a nonrefundable tax credit ("saver's" credit). The credit is a percentage of the taxpayer's contributions up to $2,000, with the credit percentage varying from 10 percent to 50 percent, depending on the taxpayer's adjusted gross income.

2. Individual retirement arrangements (IRAs)

There are two basic types of IRAs: traditional IRAs, to which deductible or nondeductible contributions can be made, and Roth IRAs, contributions to which are not

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[2] For more detailed discussions of tax-favored retirement savings generally, as well as IRAs and defined contribution plans, see Joint Committee on Taxation, *Present Law and Background Relating to Tax-Favored Retirement Savings* (JCX-98-14), September 15, 2014. This document is available at www.jct.gov.

[3] Unless otherwise stated, all section references herein are to the Internal Revenue Code of 1986, as amended.

[4] Employer contributions to tax-favored retirement plans are also exempt from Social Security and Medicare taxes applicable to wages under the Federal Insurance Contributions Act ("FICA").

[5] Subject to some exceptions, a distribution from a tax-favored retirement savings arrangement before age 59½ that is includible in income is also subject to an additional 10-percent early withdrawal tax. Under the minimum distribution requirements, distributions from a tax-favored retirement savings arrangement (other than a Roth IRA) are generally required to begin within a certain period after attainment of age 70½ and must be taken over the individual's life or life expectancy. Minimum distribution requirements also apply after a participant's death (including to Roth IRAs). An excise tax may apply if required minimum distributions are not made.

deductible.[6] The total contributions made to all IRAs for a year cannot exceed $5,500 (for 2014), plus an additional $1,000 (which is not indexed) in catch-up contributions for individuals age 50 or older. Certain individuals are not permitted to make deductible contributions to a traditional IRA or to make contributions to a Roth IRA, depending on their income.

3. Tax-favored employer-sponsored plans

Whether to offer a tax-favored retirement plan to employees is a voluntary choice by an employer. As with other components of a compensation package, an employer may have a variety of motivations in deciding whether to offer a retirement plan. The motivations to offer a plan may be different for a large public company that is broadly owned by its stockholders than for an owner-operated company where the plan is providing retirement benefits for both the owners and their employees. For a large public company that is competing for employees with other employers that offer retirement plans, the motivation may be primarily recruitment and retention of employees. For an owner-operated company, providing for the owner's retirement may play a larger role, with providing benefits also to employees as a further consideration. For some employers, the decision to offer a plan may be subject to collective bargaining negotiations.

A key element in an employer's decision is the value that employees place on being provided benefits under a retirement plan versus receiving current compensation. A basic reason for employees to value being provided benefits under an employer-sponsored retirement plan as a portion of their total compensation is the tax deferral and savings opportunity inherent in these plans. For example, the amount of elective deferrals an employee can make to an employer-sponsored retirement plan is greater than the contributions an individual can make to an IRA. In addition, the employer may separately make nonelective or matching contributions.

For employers that decide to offer a tax-favored retirement plan, the Code provides rules as to the amount of benefits, the timing of benefit distributions, and the deductibility of contributions. The Code also imposes protections for employees to ensure that they receive the benefits promised under the plan, for example, by requiring defined benefit plans to be adequately funded and protecting the integrity of individual accounts under defined contribution plans by making sure account assets are not misused or diverted; parallel rules generally apply under the Employee Retirement Income Security Act of 1974 ("ERISA"). However, subject to these rules, an employer has a great deal of flexibility in deciding the structure of its retirement plan and the level of benefits, as permitted under the various types of plans available.

One element in a plan's structure is whether the employer offers retirement benefits as a unilateral benefit that the employee accepts implicitly by accepting employment with, or remaining employed by, the employer. Alternatively, within limits, the employer may allow a year-by-year choice by the employee whether to accept current compensation or make contributions to the plan. Employers may structure a retirement plan in part as a retention tool so

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[6] Secs. 408 and 408A.

that only employees who work for a certain number of years become vested in the benefits accrued under the plan (subject to vesting requirements).

The most common type of tax-favored plan is a qualified retirement plan,[7] which may be a defined benefit plan or a defined contribution plan. A defined contribution plan may include a qualified cash or deferred arrangement (called a section 401(k) plan),[8] which offers an employer great flexibility in designing a retirement program for its employees. Another option is a qualified annuity plan,[9] which is similar to and subject to requirements similar to those applicable to qualified retirement plans.

Additional options are available to certain tax-exempt or governmental employers, including tax-deferred annuities (called section 403(b) plans)[10] and eligible deferred compensation plans (called governmental section 457(b) plans),[11] which are sometimes offered in lieu of a section 401(k) plan. Certain small employers have the option of maintaining a SIMPLE IRA plan[12] or a simplified employee pension ("SEP"),[13] which are funded through direct contributions by the employer to an IRA established for each employee.

4. Qualified retirement plans and annuities

In general

A plan of deferred compensation that meets the qualification requirements under the Code (a "qualified retirement plan") is accorded tax-favored treatment as described above. In addition, in the case of a taxable employer, the employer is entitled to a current deduction (within limits) for contributions even though the contributions are not currently included in an employee's income. A qualified annuity plan is a type of retirement plan that is subject to the same requirements as qualified retirement plans and receives comparable tax-favored treatment, but plan assets consist of annuity contracts, rather than investments held in a trust or custodial account.

Present law imposes a number of requirements on qualified retirement plans that must be satisfied for favorable tax treatment to apply.[14] Some of these requirements define the rights of

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[7] Sec. 401(a).

[8] Sec. 401(k).

[9] Sec. 403(a).

[10] Sec. 403(b).

[11] Sec. 457(b).

[12] Sec. 408(p).

[13] Sec. 408(k).

[14] In general, for purposes of these requirements, members of controlled groups under section 414(b) or (c) and affiliated service groups under section 414(m) or (o) are treated as a single employer.

plan participants and beneficiaries, such as the minimum participation and vesting requirements. In addition, assets of the plan must be held in a trust or custodial account for the exclusive benefit of plan participants, and prohibited transaction rules (that is, rules prohibiting self-dealing by employers and plan fiduciaries) apply to plan assets.[15] Some qualified retirement plans are also subject to minimum funding requirements, discussed below.

Under the minimum participation rules, a plan generally cannot delay an employee's participation in the plan beyond the later of completion of one year of service (i.e., a 12-month period with at least 1,000 hours of service) or attainment of age 21.[16] In addition, a plan cannot exclude an employee from participation on the basis of attainment of a specified age. Employees can be excluded from plan participation on other bases, such as job classification, as long as the other basis is not an indirect age or service requirement.

Under the vesting rules, a participant's right to the benefits he or she has accrued under a plan ("accrued benefit") generally must become nonforfeitable after a specified period of service and at attainment of normal retirement age under the plan.[17] Benefits attributable to employee contributions must be fully vested at all times. The period of service after which benefits attributable to employer contributions must be vested depends on the type of plan (defined benefit or defined contribution), as discussed below.

Qualified retirement plans are also subject to regulation under ERISA, which generally is under the jurisdiction of the Department of Labor ("DOL"). The ERISA rules generally relate to the rights of plan participants and beneficiaries, reporting and disclosure, and the obligations of plan fiduciaries. Some of the provisions of the Code and ERISA that apply to qualified retirement plans are identical or very similar.[18] For example, ERISA includes minimum participation and vesting requirements that parallel those under the Code.[19]

Enforcement of qualified retirement plan requirements

In general

Enforcement of a qualified retirement plan requirement depends on the source of the requirement. The qualification requirements under the Code are enforced by the IRS. If a plan fails to meet the qualification requirements, then the favorable tax treatment for such plans may

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[15] Secs. 401(a)(2) and 4975. Under this exclusive benefit requirement, prior to satisfaction of all liabilities under the plan with respect to employees and their beneficiaries assets are not allowed to be used for or diverted to purposes, other than the exclusive benefit of employee or their beneficiaries.

[16] Sec. 410(a).

[17] Sec. 411.

[18] Governmental plans and church plans are generally exempt from ERISA and from the Code requirements that correspond to ERISA requirements.

[19] ERISA secs. 202 and 203.

be denied; that is, the employer may lose tax deductions and employees may have current income taxation. As a practical matter, the IRS rarely disqualifies a plan. Instead, the IRS may impose sanctions short of disqualification and require the employer to correct any violation of the qualification rules.

Certain of Code requirements for qualified plans are enforced through an excise tax rather than through disqualification. For example, a failure to satisfy the minimum funding requirements for defined benefit plans, discussed below, does not result in disqualification of the plan. Instead, an excise tax is imposed on the employer. Employees do not have a right to sue to enforce the qualified retirement plan requirements under the Code.

ERISA's requirements generally may be enforced through administrative actions by DOL or by lawsuits brought by plan participants, DOL, or plan fiduciaries.

Preapproved plans and Employee Plans Compliance Resolution System

Under the Code, an employer or other plan sponsor may obtain an advance determination from the IRS that the terms of its retirement plan comply with the qualification requirements.[20] In addition, the IRS has established an extensive program under which banks, insurance companies, and similar institutions ("service providers") can obtain advance IRS approval of standardized qualified retirement plan documents ("preapproved plans") that can be adopted by employers without each employer having to retain its own legal professionals to draft plan documents for the employer.[21] A service provider offering a preapproved plan document generally also offers plan-related services, such as holding and managing plan assets, plan record-keeping, participant notices and distributions, and annual reporting to the IRS, DOL and the PBGC. The preapproved plan program helps to make adopting and maintaining a qualified retirement plan more affordable for employers, especially smaller employers.

Because of the complexity of the requirements for qualified retirement plans, errors in plan documents, as well as plan operation and administration commonly occur. Under a strict application of these requirements, such an error would cause a plan to lose its tax-favored status, the consequences of which would fall most heavily on plan participants. To avoid this result, the IRS has established the Employee Plans Compliance Resolution System ("EPCRS"), which permits employers to correct compliance failures and continue to provide their employees with retirement benefits on a tax-favored basis.[22]

EPCRS has three components, providing for self-correction, voluntary correction with IRS approval, and correction on audit. The Self-Correction Program ("SCP") generally permits

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[20] If the IRS fails to issue a favorable determination, under section 7476, the employer or plan sponsor may bring a declaratory judgment action in the U.S. Tax Court.

[21] See Rev. Proc. 2011-49, 2011-44 I.R.B. 608, for background on the preapproved plan program. Under the program, preapproved plans include master and prototype and volume submitter plans.

[22] Since establishing the program, the IRS has regularly updated and expanded it. The current program is described in Rev. Proc. 2013-12, 2013-4 I.R.B. 313.

a plan sponsor that has established compliance practices and procedures to correct certain insignificant failures at any time (including during an audit), and certain significant failures generally within a two-year period, without payment of any fee or sanction. The Voluntary Correction Program ("VCP") permits an employer, at any time before an audit, to pay a limited fee and receive IRS approval of a correction. For a failure that is discovered on audit and corrected, the Audit Closing Agreement Program ("Audit CAP") provides for a sanction that bears a reasonable relationship to the nature, extent, and severity of the failure and that takes into account the extent to which correction occurred before audit.

Types of qualified retirement plans

Defined benefit and defined contribution plans

Qualified retirement plans are broadly classified into two categories, defined contribution plans and defined benefit plans, based on the nature of the benefits provided.[23] Although both types of plans are subject to the qualification requirements, the requirements differ somewhat for the two types of plans.

Under a defined contribution plan, a separate account is maintained for each participant, to which contributions are allocated and investment earnings (and losses) are credited. A participant's benefits are based solely on the participant's account balance. Because the account balance, and thus the participant's benefits, depends on the rate of return on the account, the risk of investment loss (and reward of investment gain) under a defined contribution plan lies with the participant rather than the employer.

Under a defined benefit plan, benefits are determined under a plan formula. Benefits under a defined benefit plan are funded by the general assets of the trust established under the plan which are invested by plan fiduciaries in accordance with plan terms; individual accounts are not maintained for employees participating in the plan. Employer contributions to a defined benefit plan are generally subject to minimum funding requirements intended to ensure that plan assets are sufficient to pay the benefits under the plan. Benefits under defined benefit plans are generally guaranteed (within limits) by the Pension Benefit Guaranty Corporation ("PBGC").

Certain types of qualified retirement plans are referred to as hybrid plans because they have features of both a defined benefit plan and a defined contribution plan. For example, a cash balance plan is a hybrid plan. Legally, a cash balance plan is a defined benefit plan; however, plan benefits are defined by reference to a hypothetical account balance.

[23] Under the Code as in effect since before ERISA, retirement plans fall into three general types - pension plans, profit sharing plans, and stock bonus plans, defined respectively at Treas. Reg. sec. 1.401-1(b)(1)(i), (ii), and (iii). Defined benefit plans and money purchase pension plans (a type of defined contribution plan) are pension plans under the Code; other defined contribution plans are either profit-sharing plans or stock bonus plans. The application of some Code requirements depends on whether the plan is a pension plan, a profit-sharing plan, or a stock bonus plans plan. Under ERISA, the term "pension plan," defined at ERISA section 3(2)(A), includes both defined benefit plans and defined contribution plans. Under ERISA, defined contribution plans are also referred to as individual account plans.

Single-employer, multiple-employer and multiemployer plans

Qualified retirement plans are also categorized by the number of employers that maintain the plan and the type of employees covered by the plan.

A single-employer plan is a plan maintained by one employer; members of controlled groups and affiliated service groups are treated as one employer for this purpose. A single-employer plan may cover employees who are also covered by a collective bargaining agreement ("collectively bargained employees"), pursuant to which the plan is maintained (a "collectively bargained plan").[24] An employer may maintain separate plans for collectively and noncollectively bargained employees, or they may be covered by the same plan.

A multiple-employer plan is a single plan in which two or more unrelated employers (that is, not members of the same controlled group or affiliated service group) participate but that is not a multiemployer plan described below.[25] Multiple-employer plans are commonly maintained by employers in the same industry, and, more recently, are used by businesses referred to as professional employer organizations ("PEOs") to provide qualified defined contribution plans to employees working for PEO clients.[26] Some qualification requirements are applied to a multiple-employer plan on a plan-wide basis. For example, all employees covered by the plan are treated as employees of all employers participating in the plan for purposes of the exclusive benefit rule. Similarly, an employee's service with all participating employers is taken into account in applying the minimum participation and vesting requirements, and compensation with all participating employers is taken into account in applying limits on benefits and contributions. Other requirements are applied separately, including the minimum coverage requirements, nondiscrimination requirements (both the general requirements and the special tests for section 401(k) plans) and the top-heavy rules.

Multiemployer plans (also known as "Taft-Hartley" plans, and distinct from multiple-employer plans) are plans maintained pursuant to one or more collective bargaining agreements with two or more unrelated employers and to which the employers are required to contribute under the collective bargaining agreement(s).[27] Multiemployer plans commonly cover collectively bargained employees in a particular industry. A multiemployer plan is not operated by the contributing employers; instead, it is governed by a board of trustees ("joint board") consisting of labor and employer representatives.

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[24] Treas. Reg. sec. 1.410(b)-6(d).

[25] Sec. 413(c) and ERISA sec. 210(a).

[26] Rev. Proc. 2003-86, 2003-2 C.B. 1211, and Rev. Proc. 2002-21, 2002-1 C.B. 911, address the application of the multiple-employer plan rules to defined contribution plans maintained by PEOs.

[27] Sec. 414(f) and ERISA sec. 2(37).

Defined contribution plans

In general

Defined contribution plans may provide for nonelective contributions and matching contributions by employers and pretax or after-tax contributions by employees. Total contributions made to an employee's account for a year cannot exceed the lesser of $52,000 (for 2014) or the employee's compensation. The deduction for employer contributions to a defined contribution plan for a year is generally limited to 25 percent of the participants' compensation. A participant must at all times be fully vested in his or her own contributions to a defined contribution plan and must vest in employer contributions under three-year cliff vesting or two-to-six-year graduated vesting.

In the case of a defined contribution plan, nondiscrimination testing, discussed further below, is generally based on the amount of employer nonelective contributions allocated to participants' accounts ("allocations"). Special nondiscrimination tests apply to section 401(k) plans and employer matching contributions and after-tax employee contributions.

Defined contribution plans often provide for loans to participants and generally provide for distributions on severance from employment and, depending on the type of plan, may provide for in-service distributions. Defined contribution plans may provide for distributions to be made in a lump sum or installments; defined contribution plans may offer annuity distributions, but most are not required to offer annuities.

Types of defined contribution plans

Defined contribution plans may themselves be of different types, specifically, profit-sharing plans, stock bonus plans, or money purchase plans, and may include special features, such as a qualified cash or deferred arrangement (a section 401(k) plan) or an employee stock ownership plan ("ESOP").

Under a section 401(k) plan, an employee may elect to have contributions (elective deferrals) made to the plan, rather than receive the same amount in cash. For 2014, elective deferrals of up to $17,500 may be made, plus, for employees aged 50 or older, up to $5,500 in catch-up contributions. Elective deferrals are generally made on a pretax basis. However, a section 401(k) plan may include a qualified Roth contribution program under which elective deferrals are made on an after-tax basis (designated Roth contributions), and certain distributions ("qualified distributions") are excluded from income. Many section 401(k) plans provide for matching contributions and may also provide for employer nonelective contributions and after-tax employee contributions.

An ESOP is a stock bonus plan that is designated as an ESOP and is designed to invest primarily in employer stock. An ESOP can be an entire plan or it can be a portion of a defined contribution plan. ESOPs are subject to additional requirements that do not apply to other plans that hold employer stock. In addition, certain benefits are available to ESOPs that are not available to other types of qualified retirement plans, including an exception to the prohibited transaction rules for certain loans and, in the case of a C corporation, higher deduction limits.

Owner-employees

In general

Qualified retirement plans are required to be maintained for the exclusive benefit of employees. Depending on the entity structure used for a business, business owners may be employees or self-employed. In the case of a corporation, including an S corporation, business owners are employees. In the case of a sole proprietorship or partnership, business owners are self-employed. However, for qualified retirement plan purposes, self-employed individuals are treated as employees.[28]

Although the qualified retirement plan rules generally apply to self-employed individuals in the same manner as to employees, special rules apply in determining the compensation of a self-employed individual and the deduction for plan contributions to provide the self-employed individual with contributions or benefits under the plan.

For qualified retirement plan purposes, a self-employed individual's compensation ("earned income") is net earnings from self-employment as defined for purposes of the Self-Employment Contributions Act ("SECA"), with certain adjustments.[29] For example, the contributions made to a qualified retirement plan to provide the self-employed individual with contributions or benefits under the plan (the "self-employed deduction") are not deductible for SECA purposes. However, the deduction does apply in calculating earned income, thus reducing the compensation used to determine contributions or benefits for the self-employed individual under the plan. In addition, if a self-employed individual has more than one trade or business, only earned income from the trade or business with respect to which the plan is maintained may be taken into account under the plan.

Subject to limits, an employer, including a self-employed individual, may deduct as business expenses contributions made to a qualified retirement plan to provide contributions or benefits for employees participating in the plan. In the case of a defined contribution plan, the limit is generally 25 percent of the employees' total compensation. The deduction for these contributions is in addition to any deduction for the employees' compensation used to determine their contributions or benefits. However, because the self-employed deduction reduces the self-employed individual's earned income, the amount that can be deducted is also reduced. For example, depending on the rate of contributions under a defined contribution plan, the self-employed deduction may be limited to 20 percent of net earnings from self-employment, rather than the 25-percent general limit.

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[28] Sec. 401(c)(1).

[29] Sec. 401(c)(2). Under section 1402(a), net earnings from self-employment are generally the individual's gross income from a trade or business minus deductions attributable to the business.

Top heavy rules

Top-heavy rules apply to limit the extent to which accumulated benefits or account balances under a qualified retirement plan can be concentrated with key employees.[30] Whereas the general nondiscrimination requirements, discussed below, are designed to test annual contributions or benefits for highly compensated employees, compared to those of nonhighly compensated employees, the top-heavy rules test the portion of the total plan contributions or benefits that have accumulated for the benefit of key employees as a group. If a plan is top-heavy, minimum contributions or benefits for nonkey employees and, in some cases, faster vesting is required.

For this purpose, a key employee is an officer with annual compensation greater than $170,000 (for 2014), a five-percent owner, or a one-percent owner with compensation in excess of $150,000. A defined benefit plan generally is top-heavy if the present value of cumulative accrued benefits for key employees exceeds 60 percent of the cumulative accrued benefits for all employees. A defined contribution plan is top-heavy if the aggregate of accounts for key employees exceeds 60 percent of the aggregate accounts for all employees. The nature of the top-heavy test is such that a plan of a large business with many employees is unlikely to be top-heavy. The top-heavy requirements are therefore viewed as primarily affecting plans of smaller employers in which the owners participate.

Tax credit for small employer pension plan start-up costs

Present law provides a nonrefundable income tax credit for qualified start-up costs of an eligible small employer that adopts a new qualified retirement plan (or an IRA-based employer-sponsored plan), provided that the plan covers at least one nonhighly compensated employee.[31] Qualified start-up costs are expenses connected with the establishment or administration of the plan or retirement-related education for employees with respect to the plan. The credit is the lesser of $500 per year or 50 percent of the qualified start-up costs. The credit applies for up to three years beginning with the year the plan is first effective, or, at the election of the employer, the preceding year.

An eligible employer is an employer that, for the preceding year, had no more than 100 employees with compensation of $5,000 or more. In addition, the employer must not have had a plan covering substantially the same employees as the new plan during the three years preceding the first year for which the credit would apply. Members of controlled groups and affiliated service groups are treated as single employers for purposes of these requirements.

[30] Secs. 401(a)(10)(B) and 416.

[31] Sec. 45E.

B. Defined Benefit Plans

1. Overview

In general

As discussed above, benefits under defined benefit plan are based on a plan formula, rather than based on assets in an actual account balance maintained for a participant or actual plan assets. Traditionally, a defined benefit plan formula has determined benefits as a life annuity commencing at normal retirement age, based on a formula that takes into account an employee's compensation and years of service (referred to as a traditional defined benefit plan formula or a traditional defined benefit plan). However, under some defined benefit plans, benefits are determined by reference to hypothetical account balances that resemble accounts maintained for participants under a defined contribution plan. These plans are commonly referred to as hybrid plans because they have features of both a defined benefit plan and a defined contribution plan. However, legally, they are defined benefit plans.

Subject to the applicable qualification rules, the employer (and, in the case of collectively bargained plans, employee representatives) determines the benefit formula under a defined benefit plan, as well as other plan features. Thus, benefits under such plans vary from employer to employer, and, in some cases, from plan to plan of the same employer.

Benefits under a defined benefit plan are funded by the general assets of the trust established under the plan, which are invested by plan fiduciaries in accordance with plan terms. Defined benefit plans are generally funded by employer contributions, in an amount determined on an actuarial basis to be needed over time to provide the benefits under the plan, and, as discussed below, employers are generally subject to minimum funding requirements with respect to defined benefit plans. Most defined benefit plans of private employers are insured by the PBGC, for which specified premiums are required.[32]

Historically, the common view has been that, because benefits under a defined benefit plan are funded by trust assets generally and the funding rules require employer contributions to fund the promised benefits, investment risk under a defined benefit plan is born by the employer. However, participants in an underfunded defined benefit plan also bear the risk of losing benefits in the case of a distress termination of a single-employer defined benefit plan, as discussed below, or, in the case of a multiemployer defined benefit plan, as a result of benefit reductions under a plan in critical status or plan insolvency, as discussed below. In addition, as discussed below, the PBGC bears some of the risk associated with underfunded defined benefit plans.

Qualification requirements

The specifics of some qualification requirements vary between defined benefit plans and defined contribution plans. In some cases, such as the vesting requirements, discussed below, some aspects apply only to defined benefit plans. In addition, some qualification requirements

[32] Title IV of ERISA.

apply only to defined benefit plans. For example, under a defined benefit plan, forfeitures cannot be used to increase benefits.[33]

The formula under a defined benefit plan must provide benefits that are definitely determinable.[34] In order to satisfy this requirement, if the amount of a benefit under a defined benefit plan is determined on the basis of actuarial assumptions, the assumptions must be specified in the plan in a way that precludes employer discretion.[35] For example, a plan may specify that a variable interest rate will be used in determining actuarial equivalent forms of benefit, but may not give the employer discretion to choose the interest rate. Below is a discussion of selected qualification requirements for defined benefit plans.

2. Common defined benefit plan designs

Final average pay plans

Under a final average pay plan, an employee's benefit is based on the average of the employee's compensation for a certain number of years (for example, three or five years). Generally, the years taken into account are the most recent years (for example, the three or five most recent years) or, if applicable, an earlier period of years in which the employee's average compensation is the highest.

The formula used to determine an employee's normal retirement benefit under a final average pay plan may be a unit credit formula or a flat benefit formula.[36] A unit credit formula provides a specified rate of benefit for each year of service, often with a limit on the years of service taken into account. For example, a plan may provide a normal retirement benefit of 1.5 percent of final average pay for each year of service up to 30 years.[37] A flat benefit formula provides a normal retirement benefit of a specified percentage without regard to years of service, for example, 50 percent of final average pay, which a participant generally accrues over the participant's years of participation in the plan.

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[33] Sec. 401(a)(8).

[34] The definitely determinable benefit requirement, imposed under Treas. Reg. secs. 1.401 1(b)(1)(i) and 1.401(a) 1(b)(1)(i), applies to money purchase pension plans as well as defined benefit plans.

[35] Sec. 401(a)(25).

[36] The benefit formula describes the benefit payable under the plan at normal retirement age. However, the benefit payable to an employee in the case of termination of employment (or termination of the plan) before normal retirement age depends on the portion of the normal retirement benefit that has accrued, which is determined under the plan's accrual method, as discussed below. In addition, the amount of the accrued benefit payable to the employee depends on the extent to which the employee's right to the accrued benefit is vested.

[37] A unit credit formula may provide different benefit rates for different years of service (for example, one percent of final average pay for each year of service up to 15 years and 1.25 percent of final average pay for each year of service from 16 to 30 years), subject to the accrual rules discussed below.

Because the normal retirement benefit under a final average pay plan is based on an employee's most recent or highest pay, increases in an employee's pay are reflected in the employee's entire benefit. As a result, under a unit credit benefit formula, for an employee with a long period of service, compensation increases generally result in significant benefit increases because the compensation increase is reflected in the benefit attributable to all years of service. In addition, in the case of an employee who works for the employer until retirement, the retirement benefit is based on the employee's most recent or highest pay at the time of retirement.

Career average pay plans

Under a career average pay plan, an employee's normal retirement benefit consists of the sum of separate benefits determined for each year of service, based on compensation for the year of service. For example, a career average plan may provide a benefit of 1.5 percent of compensation for each year of service, with the total normal retirement benefit consisting of the sum of the separate benefits determined for each year of service. This plan design is also referred to sometimes as an accumulation plan. Under a career average plan, an increase in an employee's compensation does not affect the portion of the employee's normal retirement benefit attributable to previous years of service.[38]

Integration with Social Security benefits

Under the design of the Social Security system, an employer pays Social Security taxes on an employee's compensation and, as a result, is considered to provide a portion of the employee's Social Security benefits. Because Social Security taxes - and benefits - are based on an employee's compensation only up to the wage base ($117,000 for 2014), some defined benefit plan formulas either provide a higher rate of benefit with respect to compensation not taken into account in determining social security benefits or offset benefits otherwise determined under the plan formula by a portion of a participant's expected social security benefits. This is referred to as Social Security integration.[39]

Flat dollar plans

Some plans provide a specified dollar amount of annuity benefit at retirement for each year of service, regardless of the particular participant's compensation, referred to as a flat dollar

[38] An employer maintaining a career average plan may periodically amend the plan to provide a one-time benefit adjustment under which the employee's benefit is the greater of (1) the benefit determined under the career average formula for the employee's completed years of service, and (2) the benefit determined under a final average pay formula, based on final average compensation as of the year in which the amendment applies and the employee's completed years of service. For subsequent years (that is, years after the year in which the amendment applies), the employee's benefit consists of the sum of (1) the benefit determined under the amendment and (2) the benefit determined under the career average formula for years of service in subsequent years.

[39] As noted in the discussion of the nondiscrimination requirements applicable to defined benefit plans below, the permitted disparity rules under sections 401(a)(5)(C) and 401(l) enable benefits under an integrated plan to satisfy the nondiscrimination requirements.

benefit. The dollar amount of the benefit can be an annual amount or a monthly amount. Typically, the dollar amount of the benefit is higher at greater periods of service. Multiemployer defined benefit plan often use this type of benefit formula.

Cash balance and other hybrid plans

A cash balance plan is a defined benefit plan under which benefits are defined by reference to a hypothetical account balance maintained for each participant. An employee's hypothetical account is determined by reference to hypothetical annual allocations to the account (generally called "pay credits" or "service credits"), such as a specified percentage of the employee's compensation for the year), and hypothetical earnings on the account (generally called "interest credits").

Hypothetical earnings on the account may be determined in the form of interest on the account at a rate specified in the plan or based on a specified market index, such as the rate of interest on certain Treasury securities. Alternatively, hypothetical earnings on the account may be based on hypothetical assets held in the account, similar to earnings on an account under a defined contribution plan, which are based on the assets held in the account. In that case, the plan may permit the employee to designate the hypothetical assets on which hypothetical earnings are based or permit the employee to choose from hypothetical investment options.[40]

As under defined benefit plans generally, normal retirement benefits under a cash balance plan (or other hybrid plan) are payable in the form of an annual benefit commencing at normal retirement age. Under a cash balance plan, the annual benefit payable to an employee at normal retirement age is generally determined as the actuarial equivalent of the amount of the employee's hypothetical account balance at normal retirement age, using actuarial factors specified in the plan. In addition, lump-sum distributions from cash balance plans are generally based on the employee's hypothetical account balance at the time the distribution is made.

Under some hybrid plans, a participant's hypothetical account may be determined as a percentage of the participant's final average pay multiplied by the participant's years of service. Thus, increases in a participant's final average pay apply to the participant's accumulated balance. This plan design is generally referred to as a pension equity plan.

Contributory defined benefit plans

Some defined benefit plans provide for employee contributions, referred to as a contributory defined benefit plan. Contributory defined benefit plans are fairly common among governmental defined benefit plans, but not among plans maintained by private employers.

Generally, employee contributions to a defined benefit plan are made on an after-tax basis, which results in "basis" in the employee's benefit that reduces the taxable portion of a later

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[40] The assets of the cash balance plan may or may not include the assets or investments on which hypothetical earnings are based. As in the case of other defined benefit plans, a plan fiduciary would be responsible for making investment decisions with respect to cash balance plan assets.

distribution.[41] However, under a special rule, employee contributions to a plan maintained by a State or local government employer may be "picked up" by the employer and made on a pre-tax basis.[42]

A defined benefit plan may be designed to provide for mandatory or voluntary employee contributions. In the case of mandatory contributions, an employee must make the contributions in order to be covered by the defined benefit plan and receive employer-provided benefits (or additional employer-provided benefits) under the plan. Depending on the plan design chosen by the employer, an employee may be given the choice (generally at the start of employment or after completing a year of service) of whether to make mandatory contributions and participate in the plan, so that employee contributions are a condition of participation in the plan. Alternatively, employee contributions may be required as a condition of employment, that is, all employees must make contributions and participate in the plan.

Voluntary employee contributions to a defined benefit plan are maintained in a separate account, to which income, expenses, gains, and losses are allocated. Benefits attributable to the employee contributions are based on the balance of the separate account. This separate account is treated as a defined contribution plan for certain purposes.

Cost-of-living adjustments

Generally the amount of an employee's annual retirement benefit from a defined contribution plan is determined at retirement and does not change. However, some defined benefit plans provide for post-retirement benefit increases based on cost-of-living adjustments ("COLAs"). A COLA may be provided automatically as part of the normal retirement benefit under the plan (an "automatic" COLA) or may be provided by a plan amendment made at the time (or times) the employer deems a COLA to be appropriate (an "ad hoc" COLA).

Insurance contract plans

An insurance contract plan is a defined benefit plan that meets the following requirements: (1) the plan is funded exclusively by the purchase of individual insurance contracts; (2) the contracts are paid for by level annual premiums over the period beginning with each individual's participation in the plan and ending not later than the retirement age of each individual; (3) benefits under the plan equal the benefits provided under the contracts at normal retirement age under the plan and are guaranteed by the insurance carrier; (4) premiums payable for the plan year, and all prior plan years, have been paid; (5) no rights under the contracts have

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[41] Employee elective deferrals under a qualified cash or deferred arrangement (that is, a section 401(k) plan) are made on a pretax basis. Under a qualified cash or deferred arrangement, benefits (other than employer matching contributions) must not be contingent on the employee's election to make deferrals. This rule prevents employee contributions to a defined benefit plan, even if voluntary, from being treated as pretax elective deferrals because benefits under a contributory defined benefit plan depend in part on employee contributions.

[42] Sec. 414(h)(2).

been subject to a security interest at any time during the plan year; and (6) no policy loans are outstanding at any time during the plan year.[43]

[43] Sec. 412(e)(3). Group insurance contracts may be used rather than individual insurance contracts if certain requirements are met. Under sections 411(b)(1)(F) and 412(e)(2)(B), a special accrual rule applies to insurance contract plans, and such plans are exempt from the funding requirements (discussed below).

C. Selected Qualification Requirements for Defined Benefit Plans

1. Vesting, accrual and anti-cutback rules

<u>**Vesting generally**</u>

The vesting and related requirements applicable under the Code and ERISA generally provide protection for the participant's accrued benefit and optional forms of benefit, including subsidized optional forms of benefit under a defined benefit plan.[44] In the case of a defined benefit plan, a participant's accrued benefit is the portion of the normal retirement benefit (that is, the annuity payable at normal retirement age under the plan's benefit formula, based on the participant's compensation and years of service) that has accrued under the accrual method provided under the plan. For purposes of these rules, normal retirement age is generally the age specified for normal retirement under the plan, but may not be later than age 65 or, if later, the fifth anniversary of the time a participant commences participation in the plan.[45]

Generally, an employee's accrued benefit must become nonforfeitable (that is, vested) after the completion of a specified number of years of service in accordance with a vesting schedule, or, if earlier, at normal retirement age or on plan termination (to the extent benefits are funded[46]).[47] In the case of a defined benefit plan (other than a hybrid plan), the plan can also use one of two vesting schedules with respect to a participant's accrued benefit derived from employer contributions. Under the first vesting schedule, the participant's accrued benefit derived from employer contributions must become 100 percent vested upon completion of no more than five years of service (referred to as five-year cliff vesting). Under the second vesting schedule, the participant's accrued benefit derived from employer contributions must become vested ratably over the period from three to seven years of service. Under a hybrid plan, the participant's accrued benefit generally must be 100 percent vested after completion of three years of service (three-year cliff vesting). A plan may provide for the employer-provided portion of the accrued benefit to become fully vested after fewer years of service than under one of the required vesting schedules or become immediately vested when accrued.

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[44] Sec. 411 and ERISA secs. 203-204. For purposes of these requirements, under sections 414(b), (c) and (m), all employees of controlled group members and affiliated service group members are treated as employed by a single employer. The vesting and related requirements generally do not apply to governmental plans or church plans that meet certain Code requirements as in effect before ERISA.

[45] Sec. 411(a)(8) and ERISA sec. 3(24).

[46] As discussed below, benefits must be fully funded in the case of a standard termination of a single-employer defined benefit plan.

[47] Certain forfeitures are permitted for accrued benefits that fully vested; for example, forfeiture upon the participant's death or withdrawal of mandatory employee contributions and suspension of benefits upon reemployment.

Accrued benefits attributable to employee contributions must be nonforfeitable at all times. Specific rules apply for determining the portion of any accrued benefit under a defined benefit plan that is attributable to mandatory employee contributions.[48]

A defined benefit plan may also provide for certain ancillary benefits, which are not part of the participant's accrued benefit, such as disability or death benefits. Ancillary benefits are not subject to the vesting requirements or to the accrual and or anti-cutback requirements discussed below.

Accrual rules

In general terms, a participant's accrued benefit represents the benefit that the participant has earned or "accrued" under the plan as of a given time. For example, if a participant terminates employment before reaching normal retirement age, the benefit to which the participant is entitled to receive on reaching normal retirement age is the accrued benefit. The plan must specify the method used to determine the participant's accrued benefit, that is, the portion of a participant's normal retirement benefit that has been earned as of a given time, referred to as the plan's accrual method.

Under the accrual rules, participants' accrued benefits under a defined benefit plan must be determined under one of three permissible accrual methods.[49] These rules relate to the pattern in which a participant's normal retirement benefit is earned over the participant's years of service. The accrual rules limit the extent to which benefit accruals can be "backloaded," that is, they limit the extent to which rates of accrual can be higher for later years of service, which could undercut the vesting requirements. The accrual rules are sometimes referred to as the anti-backloading rules.

Reductions in an employee's rate of accrual under a defined benefit plan due to increasing age generally are also prohibited. Special rules apply for purposes of determining whether a hybrid plan satisfies this requirement.

Other forms of benefit

Optional forms of benefit

A defined benefit plan is permitted to provide a wide variety of optional forms in which distribution of the accrued benefit will be made, but each form must provide payments that are not less than the actuarial equivalent of the accrued benefit, or an impermissible forfeiture will occur.

In some cases, a defined benefit plan may provide for an early retirement benefit that is subsidized (that is, it has a greater actuarial value than the normal form of benefit) or another

[48] Sec. 411(c) and ERISA sec. 204(c).

[49] Sec. 411(b) and ERISA sec. 204(b).

retirement-type subsidy. For example, the normal form of benefit under a plan might be a life annuity commencing at normal retirement age, but the plan may provide an early retirement benefit without a full actuarial reduction in the participant's annuity payments. The right to subsidized forms of benefit is not required to vest or accrue in accordance with the vesting schedules or accrual rules described above. For example, a plan with a normal retirement age of 65 might provide for payment of a participant's accrued benefit at age 55 without actuarial reduction for early commencement, but condition entitlement to the subsidized benefit on retirement from service with the employer after attaining age 55 with at least 30 years of service.

Minimum lump-sum calculation

In the case of a distribution from a defined benefit plan of an individual's entire accrued benefit in the form of a single sum (generally referred to as a lump-sum benefit), the amount of the lump-sum benefit must not be less than the actuarial present value of the accrued benefit calculated using specified interest rates and a specified mortality table.[50] The specified interest rates (referred to as corporate bond segment rates) are determined by the Treasury Department based on a corporate bond yield curve that reflects the monthly yields on investment grade corporate bonds with varying maturities.[51] The segment rates depend on the timing of the expected payments under a participant's annuity benefit, with the first segment rate applicable to payments that would be made in the next five years, the second segment rate applicable to applicable to payments that would be made in the following 15 years, and the third segment rate applicable to payments that would be made thereafter. Thus, the interest rate that applies depends upon how many years in the future a participant's annuity payment will be made.

Subject to certain conditions, a special rule applies in the case of a hybrid plan under which each employee's accrued benefit is calculated as the balance of a hypothetical account. Under the special rule, the plan does not violate the requirements for determining lump-sum benefits merely because the plan provides that the actuarial present value of the employee's accrued benefit for purposes of determining any lump-sum distribution of the employee's entire accrued benefit is equal to the employee's hypothetical account balance.[52]

The vesting rules also prohibit a plan from distributing an employee's accrued benefit without the employee's consent (an "involuntary" distribution) before the later of the time the participant has attained normal retirement age under the plan or attained age 62.[53] An exception

[50] Sec. 417(e) and ERISA sec. 205(g)(3). These actuarial assumptions are required to determine minimum actuarial equivalent benefits under all forms of benefit other than life annuities. The mortality table used is generally the mortality table used under the funding rules for single-employer plans as discussed below.

[51] Corporate bond segment rates apply also in determining minimum required contributions under the funding rules applicable to single-employer plans and in determining variable-rate premiums for single-employer plans.

[52] Sec. 411(a)(13) and ERISA sec. 203(f). The same rule applies if the accrued benefit is calculated as an accumulated percentage of the employee's final average compensation.

[53] Section 411(a)(11) and ERISA sec. 203(e).

generally allows a lump-sum distribution without the employee's consent if the present value of the employee's accrued benefit at the time of the distribution is not more than $5,000 ("mandatory cash-out").

Plan amendments

Anti-cutback requirements

In general, a plan amendment may not reduce an employee's accrued benefit (whether or not vested), eliminate an optional form of benefit, or eliminate or reduce early retirement benefits or retirement-type subsidies with respect to the employee's accrued benefit.[54] These restrictions are referred to as the anti-cutback requirements. Amendments are permitted only to reduce future rates of accrual, or, in the case of optional forms of benefits, early retirement benefits and retirement-type subsidies, eliminate or reduce them only with respect to benefits that accrue after the amendment. However, as discussed below, certain benefits may be reduced or eliminated in the case of an underfunded single-employer or multiemployer defined benefit plan. In addition, Treasury regulations may provide exceptions to the prohibition on eliminating an optional form of benefit.

Notice of significant reduction in rate of future accruals

If an amendment to a defined benefit plan provides for a significant reduction in the rate of future benefit accrual, including any elimination or reduction of an early retirement benefit or retirement-type subsidy, the plan administrator must provide participants with written notice of the amendment.[55] The notice must be provided in a manner calculated to be understood by the average plan participant and must include sufficient information (as defined in Treasury regulations) to allow participants to understand the effect of the amendment. Under the Code, an excise tax may apply for failure to provide notice as required. Under ERISA, in addition to other enforcement action, in the case of an egregious failure to provide notice, the plan must provide the greater of the benefits provided under the amendment or the benefits to which an employee would be entitled without regard to the amendment.

2. QJSA and QPSA requirements

Defined benefit plans must comply with requirements that provide certain annuity benefits to the participant and to the spouse of a married participant.[56] In particular, defined benefit plans must provide that, whenever a distribution is permitted under the plan, the default form of benefit under the plan is a qualified joint and survivor annuity ("QJSA"). For an unmarried employee, a QJSA is a life annuity; for a married employee, a QJSA generally is a life

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[54] Sec. 411(d)(6) and ERISA sec. 204(g).

[55] Sec. 4980F and ERISA sec. 204(h).

[56] Secs. 401(a)(11) and 417 and ERISA sec. 205. These requirements also apply to money purchase pension plans, but generally not to other types of defined contribution plans that meet certain conditions.

annuity for the employee with a survivor annuity of at least 50 percent (and not more than 100 percent) for the employee's spouse.[57] The benefit must be paid in the form of a QJSA unless, after receiving a notice explaining the relative value of the QJSA to other forms of distribution, the employee elects another form of distribution and, if the employee is married, the employee's spouse provides notarized consent to the alternative form of distribution elected, as well as to any other beneficiary designated by the employee with respect to the form of distribution elected by the employee.

If a married employee dies before beginning the payment of benefits, the plan must offer a survivor benefit for the spouse in the form of a qualified preretirement survivor annuity ("QPSA"), which is a survivor annuity for the spouse that is at least 50 percent of the employee's accrued benefit. Notarized spousal consent by the employee's spouse is also required for the employee to waive the QPSA or elect a different beneficiary or a different form of survivor benefit.

In the case of a defined benefit plan, the other forms of benefit offered to a married participant under the plan are not permitted to be actuarially more valuable than the QJSA payable at the time of the distribution. Finally, the QJSA and QPSA requirements only apply if the actuarial present value of the employee's accrued benefit at the time of the distribution (calculated using the same actuarial assumptions that apply in determining minimum lump-sum benefits) is more than $5,000.

3. Restrictions on in-service distributions and phased retirement

Defined benefit plans are subject to certain additional distribution requirements under the Code, including a requirement that the plan provide benefits in the form of an annuity after retirement.[58] These requirements apply to all qualified defined benefit plans, including governmental plans and church plans.

Defined benefit plans may not provide for distributions to a participant during employment (referred to as in-service distributions) unless the participant has attained normal retirement age (or age 62, if earlier) or in the case of plan termination.[59] Under final Treasury regulations issued in 2007, the normal retirement age under a plan must be an age that is not earlier than the earliest age that is reasonably representative of the typical retirement age for the industry in which the covered workforce is employed.[60] Under the regulations, a normal retirement age of age 62 or later (age 50 or later for certain public safety employees) is deemed not to be earlier than the earliest age than is reasonably representative of the typical retirement

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[57] The plan generally must provide a second joint and survivor annuity option for married participants, a qualified optional survivor annuity ("QOSA") with a survivor annuity rate (as a percentage of the annuity during the participant's lifetime) of 50 percent or 75 percent, depending on the survivor annuity rate under the plan's QJSA.

[58] Treas. Reg. secs. 1.401-1(b)(1)(i) and 1.401(a)-1(b)(1)(i).

[59] Sec. 401(a)(36); Treas. Reg. secs. 1.401-1(b)(1)(i) and 1.401(a)-1(b)(1)(i).

[60] Treas. Reg. sec. 1.401(a)-1(b)(2).

age for the industry in which the covered workforce is employed. A normal retirement age lower than age 55 is generally presumed to be earlier that is reasonably representative of the typical retirement age for the industry in which the covered workforce is employed.

In recent years, some employees wish to work on a reduced schedule and receive partial retirement benefits (referred to as phased retirement), rather than fully retiring. However, depending on an employee's age, the restriction on in-service distributions from a defined benefit plan may preclude this as an option. Proposed Treasury regulations issued in 2004 would allow partial distributions from a defined benefit plan (referred to as phased retirement benefits) in the case of an employee at least age 59½ who reduces his or her customary work hours by at least 20 percent.[61] Certain conditions and limits would apply under the proposed regulations. For example, benefits paid to the employee may not exceed a pro rata portion determined by reference to the reduction in the employee's customary work hours. In addition, any early retirement benefit, retirement-type subsidy, and optional form of benefit that would be available on the employee's full retirement must be available with respect to the portion of benefits paid.

After issuance of the regulations, a statutory change was enacted allowing in-service distributions from a defined benefit plan at age 62 or later.[62] In a subsequent notice, the IRS requested comments on several issues, including whether in-service distributions at age 62 should consist of only unsubsidized benefits and whether final regulations should be issued to permit in-service distributions before age 62 under a phased retirement program.[63]

4. Benefit limits applicable to defined benefit plans

Under the Code, a participant's annual benefit under a defined benefit plan must generally be limited to the lesser of a dollar amount ($210,000 for 2014) and the participant's average compensation for the three years resulting in the highest average.[64] This limit applies to the aggregate of all benefits accrued by an employee under all defined benefit plans maintained by the same employer.[65] The dollar limit is prorated in the case of a participant with fewer than 10 years of participation in a plan, and the compensation limit is prorated in the case of a participant with fewer than 10 years of service with the employer.

The dollar limit applies to benefits commencing between age 62 and age 65 in the form of a straight life annuity for the life of the employee. For this purpose, a straight life annuity is

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[61] Prop. Treas. Reg. secs. 1.401(a)-1(b)(1)(iv) and 1.401(a)-3.

[62] Sec. 401(a)(36).

[63] Notice 2007-8, 2007-1 C.B. 276. No further guidance on phased retirement has been issued.

[64] Sec. 415. The compensation limit does not apply to benefits under a multiemployer plan or a governmental plan or to certain benefits under a church plan.

[65] For this purpose, members of a controlled group or affiliated service group, except a 50-percent ownership test is used.

an annuity payable in equal installments for the life of the participant that terminates upon the participant's death.

If benefits under a plan are paid in a form other than a straight life annuity commencing between age 62 and age 65, the benefits payable under the other form (including any benefit subsidies) generally cannot exceed the dollar limit when actuarially converted to a straight life annuity commencing at age 62.[66] Thus, the dollar limit is effectively reduced for distributions commencing before age 62, or for a form of benefit more valuable than a straight life annuity, and increased for distributions commencing after age 65. However, if benefits are paid in the form of a QJSA, no actuarial reduction is required to reflect the value of the survivor benefit, even if the surviving spouse annuity is 100 percent of the participant's benefit.

Under a special rule, a minimum benefit can be paid even if the benefit exceeds the normally applicable benefit limitations. Thus, the overall limits on benefits are deemed to be satisfied if the retirement benefit of a participant under all defined benefit plans of the employer does not exceed $10,000 for a year or any prior year, and the participant has not participated in a defined contribution plan of the employer. The $10,000 limit is reduced for participants with fewer than 10 years of service with the employer.

If employee contributions are made to a defined benefit plan, those contributions are taken into account in applying the limit on contributions to defined contribution plans, which is the lesser of a dollar amount ($52,000 for 2014) and the employee's compensation.

5. Nondiscrimination Requirements

<u>In general</u>

A qualified retirement plan is prohibited from discriminating in favor of highly compensated employees, referred to as the nondiscrimination requirements. These requirements are intended to ensure that a qualified retirement plan provides meaningful benefits to an employer's rank-and-file employees as well as highly compensated employees, so that qualified retirement plans achieve the goal of retirement security for both lower-paid and higher-paid employees. The nondiscrimination requirements consist of a minimum coverage requirement and general nondiscrimination requirements.[67] For purposes of these requirements, an employee generally is treated as highly compensated if the employee (1) was a five-percent owner of the

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[66] Specified interest and, in some cases, mortality assumptions apply in making these adjustments.

[67] Sections 401(a)(3) and 410(b) deal with the minimum coverage requirement; section 401(a)(4) deals with the general nondiscrimination requirements, with related rules in section 401(a)(5). Detailed regulations implement the statutory requirements. In addition to the minimum coverage and general nondiscrimination requirements, the group employees who accrue benefits under a defined benefit plan for a year must consist of at least 50 employees, or, if less, 40 percent of the workforce, subject to a minimum of two employees accruing benefits. Governmental plans are not subject to these requirements.

employer at any time during the year or the preceding year, or (2) had compensation for the preceding year in excess of $115,000 (for 2014).[68]

The minimum coverage and general nondiscrimination requirements apply annually on the basis of the plan year. In applying these requirements, employees of all members of a controlled group or affiliated service group are treated as employed by a single employer. Employees who have not satisfied minimum age and service conditions under the plan, certain nonresident aliens, and employees covered by a collective bargaining agreement are generally disregarded.[69] If a plan does not satisfy the nondiscrimination requirements on its own, it may in some circumstances be aggregated with another plan, and the two plans tested together as a single plan.

Minimum coverage requirement

Under the minimum coverage requirement, the plan's coverage of employees must be nondiscriminatory. This is determined by calculating the plan's ratio percentage, that is, the ratio of the percentage of nonhighly compensated employees (of all nonhighly compensated employees in the workforce) covered under the plan over the percentage of highly compensated employees covered. If the plan's ratio percentage is 70 percent or greater, the plan satisfies the minimum coverage requirement. If the plan's ratio percentage is less than 70 percent, a multi-part test applies. First, the plan must cover a group (or "classification") of employees that is reasonable and established under objective business criteria, such as hourly or salaried employees (referred to as a reasonable classification), and the plan's ratio percentage must be at or above a specific level specified in the regulations. In addition, the average benefit percentage test must be satisfied. Under the average benefit percentage test, the average rate of contributions or benefit accruals for all nonhighly compensated employees in the workforce (taking into account all plans of the employer) must be at least 70 percent of the average contribution or accrual rate of all highly compensated employees.

General nondiscrimination requirements

In general

Under a general nondiscrimination requirement, a qualified retirement plan may not discriminate in favor of highly compensated employees with respect to contributions or benefits. The general nondiscrimination requirements are met if (1) the amount of contributions or benefits provided under the plan are nondiscriminatory, (2) each benefit, right or feature under the plan is available to a nondiscriminatory group of employees, and (3) the timing of plan

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[68] Sec. 414(q). At the election of the employer, employees who are highly compensated based on compensation may be limited to the top 20 percent highest paid employees. A nonhighly compensated employee is an employee other than a highly compensated employee.

[69] A plan or portion of a plan covering collectively bargained employees is generally deemed to satisfy the nondiscrimination requirements. Thus, multiemployer defined benefit plans, which by definition cover collectively bargained employees, are generally deemed to satisfy the nondiscrimination requirements.

amendments does not have the effect of discriminating significantly in favor of highly compensated employees.[70]

As described above, in some circumstances, two or more plans may be aggregated and tested as a single plan for purposes the nondiscrimination requirements. In addition, the regulations implementing the general nondiscrimination requirements, allow a plan to be segmented into multiple plans, referred to as component plans, with each component plan tested separately. For example, a defined benefit plan may cover different divisions, with different benefit formulas for the employees of each division. For purposes of applying the general nondiscrimination requirements, the plan could be segmented into components, based on the portions of the plan covering employees of each division, and the requirements applied separately with respect to each component.

Nondiscrimination in the amount of contributions or benefits

There are three general approaches to testing the amount of contributions or benefits under a qualified retirement plan: (1) design-based safe harbors under which the benefit formula under a defined benefit plan, or the formula for allocating employer nonelective contributions under a defined contribution plan to participants' accounts, satisfies certain uniformity standards;[71] (2) a general test (described below); and (3) cross-testing of equivalent accruals or allocations (described below).[72] A plan is not discriminatory merely because benefit accruals or allocations for highly compensated and nonhighly compensated employees are provided as a percentage of compensation (up to $260,000 for 2014).[73] Thus, the various testing approaches are generally applied to the amount of contributions or benefits provided as a percentage of compensation.

The general test is satisfied by measuring the allocation rate (under a defined contribution plan) or accrual rate (under a defined benefit plan) of each highly compensated employee to determine if the group of employees with the same or higher rate of accrual or allocation (referred to as a rate group) is a nondiscriminatory group.[74] This test is satisfied if the ratio

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[70] Treas. Reg. sec. 1.401(a)(4)-1. With respect to the amount of contributions, employee elective deferrals under a section 401(k) plan and employer matching contributions and after-tax employee contributions to a defined contribution plan are subject to special testing rules, rather than being included in applying the general nondiscrimination requirements. In addition, the amount of employer contributions to an ESOP is tested separately from other employer contributions. Rules applicable to benefits, rights and features and the timing of plan amendments are provided in Treas. Reg. secs. 1. 401(a)(4)-4 and -5 respectively.

[71] Sections 401(a)(5)(C)-(D) and 401 (l) and Treas. Reg. secs. 1.401(l)-1 through -6 provide rules under which the benefit or allocation formula may take into account the employer-paid portion of social security taxes or benefits, referred to as permitted disparity.

[72] These approaches are explained in Treas. Reg. secs. 1.401(a)(4)-2, -3 and -8.

[73] Sec. 401(a)(5)(B).

[74] An employee's allocation rate generally is the amount of employer contributions allocated to an employee's account for the plan year, expressed as a percentage of the employee's compensation for the plan year. An employee's accrual rate generally is the amount of the annual payments under the employee's accrued benefit

percentage of the rate group (that is, the percentage of nonhighly employees in the rate group, compared with the percentage of highly compensated employees) satisfies the minimum coverage requirement. For this purpose, if the ratio percentage of the rate group is less than 70 percent, a simplified standard applies, which disregards the reasonable classification requirement and instead applies a minimum ratio percentage for the rate group (and still requires satisfaction of the average benefit percentage test). The minimum ratio percentage under this simplified standard depends on the percentage of the employer's workforce that consists of nonhighly compensated employees (the nonhighly compensated employee percentage) and ranges from (1) a minimum ratio percentage of 45 percent if the nonhighly compensated employee percentage is 60 percent or less to (2) a minimum ratio percentage 20.375 percent if the nonhighly compensated employee percentage is 99 percent.[75]

Cross-testing

Cross-testing involves the conversion of allocations or accruals to actuarially equivalent accruals or allocations, with the resulting equivalencies tested under the general test.[76] Cross-testing can also involve the aggregation of a defined benefit plan and a defined contribution plan for purposes of satisfying the nondiscrimination requirements, with the aggregated plan tested on the basis of aggregate equivalent allocations or aggregate equivalent benefits. Cross-testing of allocations under a defined contribution plan (or an aggregated defined contribution and defined benefit plan) based on equivalent benefits (or aggregate equivalent benefits) is permitted only if certain threshold requirements are met.[77]

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payable at normal retirement age in the form of a straight life annuity divided by the employee's years of service and expressed as a percentage of average annual compensation. Under the permitted disparity rules, allocation and accrual rates are then permitted to be increased by a factor to reflect the employer-paid portion of social security taxes or benefits. If a defined benefit plan provides subsidized optional forms of benefit, the accrual rate for the actuarially most valuable benefit under the plan available to each employee is also calculated and tested.

[75] If a rate group includes all highly compensated employees, the ratio percentage described above represents the percentage of nonhighly compensated employees who must be in the rate group. However, if a rate group includes only a small percentage of the employer's highly compensated employees, such as executives, the actual percentage of nonhighly compensated employees in the rate group can be quite small. In some cases, a large benefit under a qualified retirement plan may be provided to executives under a special formula that applies to them and only a small group of nonhighly compensated employees, yet still satisfies the general nondiscrimination requirements. Further, benefits are taken into account in nondiscrimination testing without regard to whether the benefits are fully vested. If turnover is high among lower-paid employees, some of those employees may later forfeit their benefits under the special formula. For the executives, the benefit under the qualified retirement plan may be combined with an offset of the executives' nonqualified deferred compensation. This structure is sometimes referred to as a qualified supplemental executive retirement plan (QSERP).

[76] An interest rate of no less than 7.5 percent and not more than 8.5 percent is required to be used for the conversion.

[77] Treas. Reg. secs. 1.401(a)(4)-8(b)(1)(i)(B) and (iii)-(iv) and 1.401(a)(4)-9(b)(2)(v). These threshold requirements were added to the regulations after a review by the Treasury Department of issues related to so-called new comparability plans under which highly compensated employees receive high allocation rates, while nonhighly compensated employees, regardless of their age or years of service, receive comparatively low allocation rates. For example, highly compensated employees in such a plan might receive allocations of 18 or 20 percent of

In order for a defined contribution plan to be tested on an equivalent benefits basis, one of the following three threshold conditions must be met:

- the plan has broadly available allocation rates, that is, each allocation rate under the plan is available to a nondiscriminatory group of employees (disregarding certain allocations provided to employees as a replacement for benefits under a defined benefit plan or a plan of an acquired business);
- the plan provides allocations that meet prescribed designs under which allocations gradually increase with age or service or are expected to provide a target level of annuity benefit; or
- the plan satisfies a minimum allocation gateway, under which each nonhighly compensated employee has an allocation rate of (a) at least one-third of the highest rate for any highly compensated employee, or (b) if less, at least five percent.

In order for an aggregated defined contribution and defined benefit plan to be tested on an aggregate equivalent benefits basis, one of the following three threshold conditions must be met:

- the plan must be primarily defined benefit in character, that is, for more than fifty percent of the nonhighly compensated employees under the plan, their accrual rate under the defined benefit plan exceeds their equivalent accrual rate under the defined contribution plan;
- the plan consists of broadly available separate defined benefit and defined contribution plans, that is, the defined benefit plan and the defined contribution plan would separately satisfy simplified versions of the minimum coverage and nondiscriminatory amount requirements; or
- the plan satisfies a minimum aggregate allocation gateway, under which each nonhighly compensated employee has an aggregate allocation rate (consisting of allocations under the defined contribution plan and equivalent allocations under the defined benefit plan) of (a) at least one-third of the highest aggregate allocation rate for any nonhighly compensated employee, or (b) if less, at least five percent in the case of a highest nonhighly compensated employees rate up to 25 percent, increased

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compensation, while nonhighly compensated employees might receive allocations of three percent of compensation. Commonly, the higher allocation rates never apply to nonhighly compensated, regardless of additional years of service or increasing age. New comparability and similar plans rely on cross-testing to satisfy the nondiscrimination requirements despite these disparate allocation rates. Moreover, there is a potential for substantially higher benefits for highly compensated employees when a defined benefit plan that benefits primarily highly compensated employees (or provides only minimal benefits to nonhighly compensated employees) is aggregated with a defined contribution plan for purposes of nondiscrimination testing. The cross-testing thresholds do not prevent an employer from structuring a defined benefit plan to apply a traditional formula to some participants and, to others, a hybrid plan formula that provides benefits similar to a new comparability defined contribution plan (or aggregated defined contribution and defined benefit plan). For further discussion, see the preamble to Treasury Decision 8954, 66 F.R. 34545, June 29, 2001.

by one percentage point for each five-percentage-point increment (or portion thereof) above 25 percent, subject to a maximum of 7.5 percent.

Closed defined benefit plans

A defined benefit plan may be amended to limit participation in the plan to individuals who are employees as of a certain date. That is, employees hired after that date are not eligible to participate in the plan. Such a plan is sometimes referred to as a closed (to new entrants) or soft-frozen defined benefit plan. In such a case, it is common for the employer also to maintain a defined contribution plan and to provide employer matching or nonelective contributions only to employees not covered by the defined benefit plan or at a higher rate to such employees.

Over time, the group of employees covered by the defined benefit plan may come to consist more heavily of highly compensated employees, for example, because of greater turnover among nonhighly compensated employees or because increasing compensation causes nonhighly compensated employees to become highly compensated. In that case, the defined benefit plan may have to be combined with the defined contribution plan and tested on a benefits basis. However, if none of the threshold conditions described is met, testing on a benefits basis may not be available.[78]

Recent IRS guidance provides temporary relief allowing a defined benefit plan closed to new entrants as of December 13, 2013, to be aggregated with a defined contribution plan and tested on an aggregate equivalent benefits basis without meeting any of the threshold conditions.[79] To be eligible for this relief, for the 2013 plan year, (1) the defined benefit plan must have satisfied the minimum coverage and general nondiscrimination requirements without aggregation with a defined contribution plan, or (2) if the defined benefit plan was aggregated with a defined contribution plan, the aggregated plan must have either been primarily defined benefit in character or consisted of broadly available separate plans, as described above. If a plan meets these requirements, the relief is available for plan years beginning before January 1, 2016.

[78] If a defined benefit plan is amended to cease future accruals for all participants (sometimes referred to as a frozen or hard-frozen defined benefit plan), in some cases, additional contributions to a defined contribution plan may be provided for older participants in order to make up in part for the loss of the benefits they expected to earn under the defined benefit plan. Similar to a closed plan, these additional contributions may make it difficult for the defined contribution plan to meet any of the threshold conditions for testing on an equivalent benefits basis.

[79] Notice 2014-5, 2014-2 I.R.B. 276. The notice also identifies additional possible amendments to the regulations to accommodate closed defined benefit plans and requests public comment.

D. Funding and Deduction Rules for Defined Benefit Plans

1. In general

Funding requirements and waivers[80]

Employer contributions to a defined benefit plan are subject to minimum funding requirements to ensure that plan assets are sufficient to pay the benefits under the plan. The amount of required annual contributions depends on whether the plan is a single-employer plan or a multiemployer plan and is determined under certain actuarial methods.[81] Minimum required contributions for a plan year must generally be made no later than 8½ months after the end of the plan year.[82]

An employer is subject to a two-tier excise tax for a failure to make required contributions unless a funding waiver is obtained.[83] The initial tax is 10 percent of the plan's aggregate unpaid minimum required contributions in the case of a single employer plan or five percent of the plan's accumulated funding deficiency in the case of a multiemployer plan. An additional tax is imposed if the failure is not corrected before the date that a notice of deficiency with respect to the initial tax is mailed to the employer by the IRS or the date of assessment of the initial tax. The additional tax is equal to 100 percent of the aggregate unpaid minimum required contributions or the accumulated funding deficiency, whichever is applicable.

Within limits, the IRS is permitted to waive all or a portion of the contributions required under the minimum funding standard for a plan year (a "funding" waiver).[84] In the case of a single-employer plan, a funding waiver may be granted if the employer responsible for the contribution could not make the required contribution without temporary substantial business hardship. In the case of a multiemployer plan, a funding waiver may be granted if 10 percent or more of the employers responsible for the contribution could not make the required contribution without substantial business hardship. In addition, in both cases, a funding waiver may be granted only if requiring the contribution would be adverse to the interests of plan participants in the aggregate. Generally, no more than three waivers (five in the case of a multiemployer plan) may be granted within any period of 15 consecutive plan years. Additional requirements apply, including notice to participants and the PBGC, restrictions on benefit increases, and security in the case of some single-employer plan funding waivers, as well as conditions that the IRS may require.

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[80] The funding rules generally do not apply to governmental or church plans.

[81] Secs. 412 and 430-432 and ERISA secs. 301-305.

[82] In the case of a single-employer plan, quarterly contributions generally must be made during a plan year if the plan had a funding shortfall for the preceding plan year.

[83] Sec. 4971.

[84] Sec. 412(c).

Deduction limits

The deduction limit for employer contributions to a defined benefit plan for a year depends on whether the plan is a single-employer plan or a multiemployer plan.[85] However, the deduction limit is never less than the contribution required under the minimum funding rules applicable to the plan. Special deduction rules apply if an employer maintains both a defined contribution plan and a defined benefit plan. If contributions exceed the amount deductible, an employer is generally subject to an excise tax of 10 percent of the excess for each year the excess remains in the plan.[86]

Use of excess plan assets for retiree health and group term life insurance benefits

Subject to various conditions, a qualified transfer of excess assets of a defined benefit plan may be made to a retiree medical account or life insurance account within the plan to fund retiree health benefits and group term life insurance benefits ("applicable retiree benefits").[87] For this purpose, excess assets generally means the excess, if any, of the value of the plan's assets over 125 percent of the sum of the plan's funding target and target normal cost for the plan year (as defined under the funding rules for single-employer plans as discussed below). A qualified transfer does not result in plan disqualification, is not a prohibited transaction, and is not treated as a reversion. No deduction is allowed to the employer for (1) a qualified transfer, or (2) the payment of applicable retiree benefits out of transferred funds (and any income thereon).

In order for the transfer to be qualified, accrued retirement benefits under the plan generally must be 100-percent vested as if the plan terminated immediately before the transfer (or in the case of a participant who separated in the one-year period ending on the date of the transfer, immediately before the separation). In addition, at least 60 days before the date of a qualified transfer, the employer must notify the Secretary of Labor, the Secretary of the Treasury, employee representatives, and the plan administrator of the transfer, and the plan administrator must notify each plan participant and beneficiary of the transfer.[88]

No more than one qualified transfer may be made in any taxable year. For this purpose, a transfer to a retiree medical account and a transfer to a retiree life insurance account in the same year are treated as one transfer. No qualified transfer may be made after December 31, 2021.

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[85] Sec. 404.

[86] Sec. 4972. If contributions for a subsequent year are less than the deduction limit for that year, the difference reduces the excess contributed for the previous year, thus reducing the amount taken into account for purposes of the excise tax for the subsequent year.

[87] Sec. 420. Qualified transfers of excess assets are generally made within single-employer defined benefit plans, but are permitted also within multiemployer plans.

[88] ERISA sec. 101(e).

Reversions

Defined benefit plan assets generally may not revert to an employer before termination of the plan and the satisfaction of all plan liabilities.[89] In addition, the plan must provide for the reversion. A reversion prior to plan termination may constitute a prohibited transaction and may result in disqualification of the plan.

Certain limitations and procedural requirements apply to a reversion on plan termination. Any assets that revert to the employer on plan termination are includible in the gross income of the employer and subject to an excise tax.[90] The excise tax rate is generally 20 percent, but increases to 50 percent if the employer does not maintain a replacement plan or make certain benefit increases.

2. Single-employer plans[91]

Minimum required contributions

The minimum required contribution for a plan year for a single-employer defined benefit plan generally depends on a comparison of the value of the plan's assets, reduced by any prefunding balance or funding standard carryover balance ("net value of plan assets"),[92] with the plan's funding target and target normal cost. The plan's funding target for a plan year is the present value of all benefits accrued or earned as of the beginning of the plan year. A plan's target normal cost for a plan year is generally the present value of benefits expected to accrue or to be earned during the plan year plus the administrative expenses expected to be paid during the year. Specified interest (as discussed below) and mortality assumptions apply in determining present value for this purpose.

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[89] The accrued benefits of all plan participants are required to be fully vested on plan termination.

[90] Sec. 4980.

[91] Before the Pension Protection Act of 2006 ("PPA"), Pub. L. No. 109-280, the funding rules for single-employer defined benefit plans and multiemployer defined benefit plans were similar, and multiple-employer plans were subject to the same rules as single-employer plans. PPA revised the funding rules for single-employer plans, effective for plan years beginning after December 31, 2007. However, PPA and the Preservation of Access to Care for Medicare Beneficiaries and Pension Relief Act of 2010 ("PRA 2010"), Pub. L. No. 111-192, provided a delayed effective date (generally until January 1, 2017) for applying the single-employer funding rules under PPA to multiple-employer plans of certain cooperative and tax-exempt organizations. Subsequently, the Cooperative and Small Employer Charity Pension Flexibility Act, Pub. L. No. 113-97, enacted new, permanent funding rules ("CSEC" rules) for these multiple-employer plans, effective for plan years beginning after December 31, 2013. The CSEC rules are similar to the rules for multiemployer plans discussed below.

[92] The value of plan assets is generally reduced by any prefunding balance or funding standard carryover balance in determining minimum required contributions. A prefunding balance results from contributions to a plan that exceed the minimum required contributions. A funding standard carryover balance results from a positive balance in the funding standard account that applied under the funding requirements in effect before PPA. Subject to certain conditions, a prefunding balance or funding standard carryover balance may be credited against the minimum required contribution for a year, reducing the amount that must be contributed.

If the net value of plan assets is less than the plan's funding target, so that the plan has a funding shortfall (discussed further below), the minimum required contribution is the sum of the plan's target normal cost and the shortfall amortization charge for the plan year (determined as described below).[93] If the net value of plan assets is equal to or exceeds the plan's funding target, the minimum required contribution is the plan's target normal cost, reduced by the amount, if any, by which the net value of plan assets exceeds the plan's funding target.

Shortfall amortization charge

The shortfall amortization charge for a plan year is the sum of the annual shortfall amortization installments attributable to the shortfall bases for that plan year and the six previous plan years. Generally, if a plan has a funding shortfall for the plan year, a shortfall amortization base must be established for the plan year.[94] A plan's funding shortfall is the amount by which the plan's funding target exceeds the net value of plan assets. The shortfall amortization base for a plan year is: (1) the plan's funding shortfall, minus (2) the present value of the aggregate total of the shortfall amortization installments, determined using specified interest rates as discussed below, that have been determined for the plan year and any succeeding plan year with respect to any shortfall amortization bases for the six previous plan years. The shortfall amortization base is amortized in level annual installments ("shortfall amortization installments") over a seven-year period beginning with the current plan year and using the specified interest rates discussed below.[95]

The shortfall amortization base for a plan year may be positive or negative, depending on whether the present value of remaining installments with respect to amortization bases for previous years is more or less than the plan's funding shortfall. If the shortfall amortization base is positive (that is, the funding shortfall exceeds the present value of the remaining installments), the related shortfall amortization installments are positive. If the shortfall amortization base is negative, the related shortfall amortization installments are negative. The positive and negative shortfall amortization installments for a particular plan year are netted when adding them up in determining the shortfall amortization charge for the plan year, but the resulting shortfall

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[93] If the plan has obtained a funding waiver within the past five years, the minimum required contribution also includes the related waiver amortization charge, that is, the annual installment needed to amortize the waived amount in level installments over the five years following the year of the waiver.

[94] If the value of plan assets, reduced only by any prefunding balance if the employer elects to apply the prefunding balance against the required contribution for the plan year, is at least equal to the plan's funding target, no shortfall amortization base is established for the year.

[95] Under PRA 2010, employers were permitted to elect to use one of two alternative extended amortization schedules for up to two "eligible" plan years during the period 2008-2011. The use of an extended amortization schedule has the effect of reducing the amount of the shortfall amortization installments attributable to the shortfall amortization base for the eligible plan year. However, the shortfall amortization installments attributable to an eligible plan year may be increased by an additional amount, an "installment acceleration amount," in the case of employee compensation exceeding $1 million, extraordinary dividends, or stock redemptions within a certain period of the eligible plan year.

amortization charge cannot be less than zero (that is, negative amortization installments may not offset normal cost).

If the net value of plan assets for a plan year is at least equal to the plan's funding target for the year, so the plan has no funding shortfall, any shortfall amortization bases and related shortfall amortization installments are eliminated.[96] As indicated above, if the net value of plan assets exceeds the plan's funding target, the excess is applied against target normal cost in determining the minimum required contribution.

Interest rate used to determine target normal cost and funding target

The minimum funding rules for single-employer plans specify the interest rates and other actuarial assumptions that must be used in determining the present value of benefits for purposes of a plan's target normal cost and funding target.

Present value is generally determined using three interest rates ("segment" rates), each of which applies to benefit payments expected to be made from the plan during a certain period. The first segment rate applies to benefits reasonably determined to be payable during the five-year period beginning on the first day of the plan year; the second segment rate applies to benefits reasonably determined to be payable during the 15-year period following the initial five-year period; and the third segment rate applies to benefits reasonably determined to be payable at the end of the 15-year period. Each segment rate is a single interest rate determined monthly by Treasury Department on the basis of a corporate bond yield curve, taking into account only the portion of the yield curve based on corporate bonds maturing during the particular segment rate period. The corporate bond yield curve used for this purpose reflects the average, for the 24-month period ending with the preceding month, of yields on investment grade corporate bonds with varying maturities and that are in the top three quality levels available. The IRS publishes the segment rates each month.

For plan years beginning after December 31, 2011, a segment rates is adjusted if the rate determined under the regular rules is outside a specified range of the average of the segment rates for the preceding 25-year period ("average" segment rates).[97] In particular, if a segment rate determined for an applicable month under the regular rules is less than the applicable minimum percentage, the segment rate is adjusted upward to match that percentage. If a segment rate determined for an applicable month under the regular rules is more than the applicable maximum percentage, the segment rate is adjusted downward to match that percentage. For this purpose, the average segment rate is the average of the segment rates determined under the regular rules for the 25-year period ending September 30 of the calendar year preceding the

[96] Any amortization base relating to a funding waiver for a previous year is also eliminated.

[97] Sec. 40211 of the Moving Ahead for Progress in the 21st Century Act (''MAP-21''), Pub. L. No. 112-141, and sec. 2003 of the Highway and Transportation Funding Act of 2014, Pub. L. No. 113 159. Besides being used in determining minimum required contributions, the segment rates are used for other purposes, such as determining minimum lump sum benefits under section 417(e). However, adjusted segment rates do not apply for all the same purposes.

calendar year in which the plan year begins. The IRS publishes the average segment rates each month.

The specified percentage range (that is, the range from the applicable minimum percentage to the applicable maximum percentage) for a plan year is determined by reference to the calendar year in which the plan year begins as follows:

- 90 percent to 110 percent for 2012 through 2017,
- 85 percent to 115 percent for 2018,
- 80 percent to 120 percent for 2019,
- 75 percent to 125 percent for 2020, and
- 70 percent to 130 percent for 2021 or later.

Solely for purposes of determining minimum required contributions, in lieu of the segment rates (or adjusted segment rates) described above, an employer may elect to use interest rates on a yield curve based on the yields on investment grade corporate bonds for the month preceding the month in which the plan year begins (that is, without regard to the 24-month averaging described above) ("monthly yield curve"). If an election to use a monthly yield curve is made, it cannot be revoked without IRS approval.

Mortality tables

In general

In determining the present value of benefits for purposes of a plan's target normal cost and funding target, specific mortality tables prescribed by the IRS must be used.[98] These tables are to be based on the actual experience of pension plans and projected trends in such experience. In prescribing tables, the IRS is required to take into account results of available independent studies of mortality of individuals covered by pension plans. In addition, the IRS is required (at least every 10 years) to revise any table in effect to reflect the actual experience of pension plans and projected trends in such experience.

The currently applicable mortality tables are specified in regulations, as updated in subsequent IRS guidance.[99] These tables are based on the tables contained in a report issued by the Society of Actuaries in July 2000, the RP-2000 Mortality Tables Report, after a study of mortality experience for retirement plan participants. The report is based on pension plan experience for 1990-94. The IRS and the Treasury Department determined that the RP -2000

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[98] Separate mortality tables are required to be used with respect to disabled participants.

[99] Treas. Reg. sec. 1.430(h)(3)-2, as updated by Notice 2008-85, 2008-42 I.R.B. 905, for valuation dates occurring in 2009-2013, and Notice 2013-49, 2013-32 I.R.B. 127, for valuation dates occurring during calendar years 2014 and 2015.

mortality tables formed the best available basis for predicting mortality of pension plan participants and beneficiaries.[100]

In guidance issued last year, the IRS and Treasury noted that a study was being conducted by the Society of Actuaries to measure the actual experience and trends in mortality for pension plan participants and an associated report, Mortality Improvement Scale BB Report, was issued in September 2012, which indicates that mortality improvement experience differs from experience previously anticipated.[101] The IRS and Treasury requested comments as to whether other studies of actual mortality experience of pension plans and projected trends of that experience are available that should be considered for use in developing mortality tables for future use under the funding rules.

The mortality tables used in valuing liability under a defined benefit plan determine the periods for which annuity benefits are expected to be paid from the plan. Those periods in turn determine the number of expected annuity payments that are taken into account in determining the present value of participant benefits as part of calculating the plan's funding target and target normal cost. The use of new mortality tables reflecting increased longevity would generally result in a larger funding target and target normal cost and higher required contributions.[102]

Substitute mortality table

In some cases, a separate mortality table (a "substitute" table) may be used upon request of the plan sponsor and approval by the IRS. In order for the table to be used: (1) the table must reflect the actual experience of the pension plans maintained by the plan sponsor and projected trends in general mortality experience, and (2) there must be a sufficient number of plan participants, and the pension plans must have been maintained for a sufficient period of time, to have credible information necessary for that purpose. A substitute mortality table can be a mortality table constructed by the plan's enrolled actuary from the plan's own experience or a table that is an adjustment to the table prescribed by the IRS which sufficiently reflects the plan's experience. A substitute table generally may not be used for any plan unless (1) a separate table is established and used for each other plan maintained by the plan sponsor and, if the plan sponsor is a member of a controlled group, each member of the controlled group, and (2) the requirements for using a separate table are met with respect to the table established for each plan, taking into account only the participants of that plan, the time that plan has been in existence, and the actual experience of that plan. In general, a substitute table may be used during the period of consecutive year plan years (not to exceed 10) specified in the request. However, a substitute mortality table ceases to be in effect as of the earlier of (1) the date on which there is a

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[100] Notice 2003-62, 2003-2 C.B. 576, and the preamble to Treasury Decision 9419 (July 31, 2008).

[101] This report is available at http://www.soa.org/files/research/exp-study/research-mortality-improve-bb-report.pdf.

[102] As with funding shortfalls generally, the employer would have a seven-year amortization period for funding an increase in funding target resulting from a change in mortality tables. Because the same mortality tables are used to determine required contributions and minimum lump-sum benefits, as described above, the use of new tables reflecting increased longevity would generally also result in larger lump-sum benefits.

significant change in the participants in the plan by reason of a plan spinoff or merger or otherwise, or (2) the date on which the plan actuary determines that the table does not meet the requirements for being used.

At-risk assumptions

Special assumptions generally apply in determining the funding target and normal cost of a plan in at-risk status ("at-risk" assumptions). Whether a plan is in at-risk status for a plan year depends on its funding target attainment percentage for the preceding year. A plan's funding target attainment percentage for a plan year is the ratio, expressed as a percentage, that the net value of the plan's assets bears to the plan's funding target for the year. A plan is in at-risk status for a year if, for the preceding year: (1) the plan's funding target attainment percentage, determined without regard to the at-risk assumptions, was less than 80 percent, and (2) the plan's funding target attainment percentage, determined using the at-risk assumptions (without regard to whether the plan was in at-risk status for the preceding year), was less than 70 percent.[103]

If a plan is in at-risk status, the plan's funding target and normal cost are determined using the assumptions that: (1) all employees who are not otherwise assumed to retire as of the valuation date, but who will be eligible to elect benefits in the current and 10 succeeding years, are assumed to retire at the earliest retirement date under plan, but not before the end of the plan year; and (2) all employees are assumed to elect the retirement benefit available under the plan at the assumed retirement age that results in the highest present value. In some cases, a loading factor also applies of four percent of the plan's funding target or normal cost, as applicable, determined without regard to at-risk status, plus, in the case of the plan's funding target, $700 times the number of participants. The effect of the at-risk assumptions on funding target and target normal cost is phased in over five years beginning with the first year of at-risk status.

Value of plan assets

In applying the single-employer funding rules, the value of plan assets generally is the fair market value of the assets. However, the value of plan assets may be determined on the basis of the averaging of fair market values, but only if such method: (1) is permitted under regulations; (2) does not provide for averaging of fair market values over more than the period beginning on the last day of the 25th month preceding the month in which the plan's valuation date occurs and ending on the valuation date; and (3) does not result in a determination of the value of plan assets that at any time is less than 90 percent or more than 110 percent of the fair market value of the assets at that time. Any averaging must be adjusted for plan contributions, distributions, and expected earnings on plan assets (as determined actuarially on the basis of an assumed rate of return not exceeding the third segment rate), as specified in administrative guidance.

[103] A similar test applies in order for an employer to be permitted to apply a prefunding balance against its required contribution, that is, for the preceding year, the ratio of the value of plan assets (reduced by any prefunding balance) must be at least 80 percent of the plan's funding target (determined without regard to the at-risk rules).

Funding-related benefit restrictions

Restrictions on benefit increases, certain types of benefits and benefit accruals (collectively referred to as benefit restrictions) may apply to a plan if the plan's adjusted funding target attainment percentage is below a certain level.[104] Adjusted funding target attainment percentage is determined in the same way as funding target attainment percentage, except that the net value of plan assets and the plan's funding target are both increased by the aggregate amount of purchases of annuities for employees, other than highly compensated employees, made by the plan during the two preceding plan years. Reductions required to comply with the benefit restrictions are not precluded by the anti-cutback rules.

Deduction limit

The deduction limit for contributions to a single-employer plan is generally the excess of (1) the sum of the plan's funding target (the present value of benefits earned under the plan in previous years), normal cost (the present value of the benefits expected to be earned during the year plus plan expenses) and a "cushion" amount, over (2) the value of plan assets. The cushion amount is the sum of 50 percent of the plan's funding target and the amount by which the funding target would increase if certain expected future compensation or benefit increases were taken into account.

Efforts to manage defined benefit plan liabilities

In recent years, many employers and their advisors have focused increasingly on approaches to better manage defined benefit liabilities, sometimes referred to as de-risking. Some approaches involve limiting liabilities, such as decisions to close a defined benefit plan to new entrants (as discussed above) or to cease ongoing benefit accruals altogether, even for current participants.

Some approaches involve limiting volatility in unfunded liabilities by changing the composition of plan assets. For example, one approach is the adoption of a liability-driven investing ("LDI") strategy, under which fixed income investments make up a larger percentage of plan assets than in the past. Plan assets may also be invested in annuity contracts, under which the annuity payments match the benefits being paid to retirees.

Alternatively, annuity contracts may be purchased and distributed to retirees in satisfaction of the plan's obligation to pay benefits, which has the effect of reducing liabilities.[105] Similarly, a plan may be amended to provide or expand the availability of voluntary lump-sum benefits to participants who have terminated employment, including in some cases retirees

[104] Sec. 436 and ERISA sec. 206(g).

[105] Plan terms commonly provide for annuity contracts to be distributed to retirees. Under Treas. Reg. sec. 1.411(d)-4, A-2(a)(3)(ii), the right to receive benefits in the form of cash payments from the plan and the right to receive the benefit in the form of an annuity contract that provides for cash payments identical in all respects to the cash payments from the plan, except with respect to the source of payments, are not separate optional forms of benefit.

receiving annuity benefits.[106] These approaches may also have the effect of reducing the plan's PBGC premiums.

3. Multiemployer plans

General funding requirements

Minimum required contributions

In connection with the funding requirements, a multiemployer defined benefit plan maintains a notional account called a "funding standard account" to which specific charges and credits (including plan contributions) are made for each plan year the multiemployer plan is maintained. The minimum required contribution for a plan year is the amount, if any, needed so that the accumulated credits to the funding standard account as of that plan year are not less than the accumulated charges (that is, so the funding standard account does not have a negative balance). If, as of the close of a plan year, accumulated charges to the funding standard account exceed credits, the plan has an "accumulated funding deficiency" equal to the amount of the excess. For example, if, as of a plan year, the balance of charges to the funding standard account would be $200,000 without any contributions, then a minimum contribution equal to that amount is required to meet the minimum funding standard for the year (that is, to prevent an accumulated funding deficiency). If credits to the funding standard account exceeds charges, a "credit balance" results. The amount of the credit balance, increased with interest, reduces future required contributions.

Funding method; charges and credits to the funding standard account

A multiemployer plan is required to use an acceptable actuarial cost method to determine the elements included in its funding standard account for a year. Generally, an actuarial cost method breaks up the cost of benefits under the plan into annual charges to the funding standard account consisting of two elements for each plan year. These elements are referred to as: (1) normal cost; and (2) supplemental cost.

The plan's normal cost for a plan year generally represents the cost of future benefits allocated to the year by the funding method used by the plan for current employees and, under some funding methods, for separated employees. Specifically, it is the amount actuarially determined that would be required as a contribution by the employer for the plan year in order to maintain the plan if the plan had been in effect from the beginning of service of the included employees and if the costs for prior years had been paid, and all assumptions (such as interest and mortality) had been fulfilled. A plan's normal cost for a plan year is charged to the funding standard account for that year.

The supplemental cost for a plan year is the cost of future benefits that would not be met by future normal costs, future employee contributions, or plan assets. The most common

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[106] The IRS has recently issued several private letter rulings holding that this approach does not violate the regulations dealing with required minimum distributions.

supplemental cost is that attributable to past service liability, which represents the cost of future benefits under the plan: (1) on the date the plan is first effective; or (2) on the date a plan amendment increasing plan benefits is first effective. Other supplemental costs may be attributable to net experience losses (for example, worse than expected investment returns or actuarial experience), losses from changes in actuarial assumptions, and amounts necessary to make up funding deficiencies for which a waiver was obtained. Supplemental costs are amortized (that is, recognized for funding purposes) over a specified number of years (generally 15 years) by annual charges to the funding standard account over that period.[107]

Factors that result in a supplemental loss can alternatively result in a gain that is recognized by annual credits to the funding standard account over a 15-year amortization period (in addition to a credit for contributions made each the plan year). These include a reduction in plan liabilities as a result of a plan amendment decreasing plan benefits, net experience gains (for example, better than expected investment returns or actuarial experience), and gains from changes in actuarial assumptions.

Actuarial assumptions; value of plan assets

In applying the funding rules to a multiemployer plan, all costs, liabilities, interest rates, and other factors are required to be determined on the basis of actuarial assumptions and methods, each of which is reasonable (taking into account the experience of the plan and reasonable expectations). In addition, the assumptions are required to offer the actuary's best estimate of anticipated experience under the plan. Unlike the funding rules for single-employer plans, the funding rules for multiemployer plan do not specify interest and mortality assumptions that must be used. Instead, the interest rate used in multiemployer plan funding computations, which represents the expected return on plan assets over time, and the mortality assumptions used are subject to these general standards.

For funding purposes, the actuarial value of plan assets may be used, rather than fair market value. The actuarial value of plan assets is the value determined under a reasonable actuarial valuation method that takes into account fair market value and is permitted under Treasury regulations. Any actuarial valuation method used generally must result in a value of plan assets that is not less than 80 percent of the fair market value of the assets and not more than 120 percent of the fair market value. In addition, if the valuation method uses average value of

[107] PPA made some changes to the funding rules for multiemployer plans, including changes to the amortization periods for some funding standard account charges and credits, effective for amounts first amortized in plan years beginning after 2007. PPA also changed the rules under which the IRS may grant an extension of the amortization period used in determining certain charges to the funding standard account, so that in some circumstances a five-year extension is automatic with an additional five-year extension available if certain requirements are met. The PPA changes to the amortization extension rules sunset (that is, no longer apply) for plan years beginning after December 31, 2014.

the plan assets, values may be used for a stated period generally not to exceed the five most recent plan years, including the current year.[108]

Withdrawal liability

An employer that withdraws from a multiemployer plan in a complete or partial withdrawal is generally liable to the plan in the amount determined to be the employer's withdrawal liability.[109] In general, a "complete withdrawal" means the employer has permanently ceased operations under the plan or has permanently ceased to have an obligation to contribute. A "partial withdrawal" generally occurs if, on the last day of a plan year, there is a 70-percent contribution decline for such plan year or there is a partial cessation of the employer's contribution obligation.

When an employer withdraws from a multiemployer plan, the plan sponsor is required to determine the amount of the employer's withdrawal liability, notify the employer of the amount of the withdrawal liability, and collect the amount of the withdrawal liability from the employer. The employer's withdrawal liability generally is based on the extent of the plan's unfunded vested benefits for the plan years preceding the withdrawal and is payable in annual installments. However, various provisions limit the amount of an employer's withdrawal liability in certain circumstances, as well as limiting the amount of the annual installments (based on the amount of the employer's previous contributions to the plan) and the period over which installments are paid (not more than 20 years).

Additional requirements for plans in reorganization status or insolvent plans

Certain modifications to the funding rules apply to multiemployer plans that experience financial difficulties, referred to as reorganization status.[110] A plan is in reorganization status for a year if the contribution needed to balance the charges and credits to its funding standard account exceeds its "vested benefits charge." The plan's vested benefits charge is generally the amount needed to amortize, in equal annual installments, unfunded vested benefits under the plan over: (1) 10 years in the case of obligations attributable to participants in pay status; and (2) 25 years in the case of obligations attributable to other participants. A plan in reorganization status is eligible for a special funding credit. In addition, a cap on year-to-year contribution increases and other relief is available to employers that continue to contribute to the plan.

Subject to certain requirements (including notice to participants, any employee organization representing participants, and contributing employers), a multiemployer plan in reorganization status may also be amended to reduce or eliminate accrued benefits in excess of

[108] PRA 2010 allowed multiemployer plans meeting certain requirements to use longer periods to recognize losses from the 2008 market downturn, both in determining charges to the funding standard account and the actuarial value of plan assets.

[109] ERISA secs. 4201-4225.

[110] Secs. 418-418D. Parallel rules are contained in sections 4241-4244A of ERISA.

the amount of benefits guaranteed by the PBGC. Benefits may be reduced or eliminated notwithstanding the anti-cutback rules, which generally require that accrued benefits may not be decreased by plan amendment. Active and inactive participants must generally be treated similarly with respect to benefit reductions made under a plan in reorganization status.

Benefit reductions may also apply if a multiemployer plan is insolvent.[111] A plan is insolvent when its available resources in a plan year are not sufficient to pay the plan benefits for that plan year, or when the sponsor of a plan in reorganization reasonably determines, taking into account the plan's recent and anticipated financial experience, that the plan's available resources will not be sufficient to pay benefits that come due in the next plan year. Notwithstanding the anti-cutback rules, an insolvent plan is required to reduce benefits to the level that can be covered by the plan's assets. However, benefits cannot be reduced below the level guaranteed by the PBGC. If a multiemployer plan is insolvent, the PBGC guarantee is provided in the form of unsecured loans to the plan (referred to as financial assistance), regardless of the plan's ability to repay the loan. However, if a plan were later to recover from insolvency status, loans from the PBGC would have to be repaid. Plans in reorganization status are required to compare assets and liabilities to determine if the plan will become insolvent in the future.

Additional requirements for plans in endangered or critical status

In general

Under PPA, effective for plan years beginning after December 31, 2007, additional funding requirements apply to multiemployer defined benefit plans in effect on July 16, 2006, that are in endangered or critical status. As discussed below, these requirements generally do not apply to plan years beginning after December 31, 2014.

In connection with these requirements, a multiemployer plan's actuary is required to certify to the IRS and to the plan sponsor each year whether the plan is in endangered status, critical status, or neither.[112] If a plan is certified to be in endangered or critical status, the plan sponsor must provide notification of the plan's status within 30 days after the date of certification to the participants and beneficiaries, the bargaining parties, the PBGC and the Secretary of Labor. If it is certified that a plan is or will be in critical status, the notice must include an explanation of the possibility that (1) adjustable benefits may be reduced (as discussed below) and (2) such reductions may apply to participants and beneficiaries whose benefit commencement date is on or after the date such notice is provided for the first plan year in which the plan is in critical status.

If a plan is certified to be in endangered or critical status, as discussed further below, the plan sponsor must adopt a funding improvement plan in the case of a multiemployer plan in

[111] Sec. 418E and ERISA sec. 4245.

[112] In the case of a plan that is in a funding improvement or rehabilitation period, as discussed below, the actuary must certify whether or not the plan is making scheduled progress in meeting the requirements of its funding improvement or rehabilitation plan.

endangered status and a rehabilitation plan in the case of a multiemployer plan in critical status.[113]

Definitions of endangered and critical status

A multiemployer plan is in endangered status if the plan is not in critical status and, as of the beginning of the plan year, (1) the plan's funded percentage for the plan year is less than 80 percent, or (2) the plan has an accumulated funding deficiency for the plan year or is projected to have an accumulated funding deficiency in any of the six succeeding plan years (taking into account amortization extensions). A plan's funded percentage is the percentage of plan assets over accrued liability of the plan. A plan that meets the requirements of both (1) and (2) is treated as in seriously endangered status.

A multiemployer plan is in critical status for a plan year if as of the beginning of the plan year:

- The funded percentage of the plan is less than 65 percent and the sum of (1) the market value of plan assets, plus (2) the present value of reasonably anticipated employer and employee contributions for the current plan year and each of the six succeeding plan years (assuming that the terms of the collective bargaining agreements continue in effect) is less than the present value of all benefits projected to be payable under the plan during the current plan year and each of the six succeeding plan years (plus administrative expenses),
- (1) The plan has an accumulated funding deficiency for the current plan year, not taking into account any amortization extension, or (2) the plan is projected to have an accumulated funding deficiency for any of the three succeeding plan years (four succeeding plan years if the funded percentage of the plan is 65 percent or less), not taking into account any amortization extension,
- (1) The plan's normal cost for the current plan year, plus interest for the current plan year on the amount of unfunded benefit liabilities under the plan as of the last day of the preceding year, exceeds the present value of the reasonably anticipated employer contributions for the current plan year, (2) the present value of nonforfeitable benefits of inactive participants is greater than the present value of nonforfeitable benefits of active participants, and (3) the plan has an accumulated funding deficiency for the current plan year, or is projected to have an accumulated funding deficiency for any

[113] Various operational restrictions, such as not reducing contributions or increasing benefits, apply during the periods after certification of endangered or critical status, after adoption of a funding improvement or rehabilitation plan, and during a funding improvement or rehabilitation period. Some of these restrictions vary, depending on whether a plan is in endangered status or critical status. For example, in the case of a multiemployer plan in critical status, certain distributions may not be made to a participant or beneficiary who begins receiving benefits after receiving notification of critical status as described above. Specifically, payments in excess of a single life annuity (plus any social security supplement, if applicable) generally may not be made. In addition, annuity contracts to provide benefits may not be purchased.

of the four succeeding plan years (not taking into account amortization period extensions), or

- The sum of (1) the market value of plan assets, plus (2) the present value of the reasonably anticipated employer contributions for the current plan year and each of the four succeeding plan years (assuming that the terms of the collective bargaining agreements continue in effect) is less than the present value of all benefits projected to be payable under the plan during the current plan year and each of the four succeeding plan years (plus administrative expenses).

Funding improvement plan

In the case of a multiemployer plan in endangered status, a funding improvement plan must be adopted within 240 days following the deadline for certifying a plan's status.[114] A funding improvement plan is a plan that consists of the actions, including options or a range of options, to be proposed to the bargaining parties, formulated to provide, based on reasonably anticipated experience and reasonable actuarial assumptions, for the attainment by the plan of certain requirements. The plan sponsor must update the funding improvement plan annually to reflect the circumstances of the multiemployer plan.

The funding improvement plan must provide that during the funding improvement period, the plan will have a certain required increase in the funded percentage and no accumulated funding deficiency for any plan year during the funding improvement period, taking into account amortization extensions (the "applicable benchmarks"). In the case of a plan that is not in seriously endangered status, under the applicable benchmarks, the plan's funded percentage must increase such that the funded percentage as of the close of the funding improvement period equals or exceeds a percentage equal to the sum of (1) the funded percentage at the beginning of the period, plus (2) 33 percent of the difference between 100 percent and the percentage in (1). Thus, the difference between 100 percent and the plan's funded percentage at the beginning of the period must be reduced by at least one-third during the funding improvement period.

The funding improvement period is generally the 10-year period beginning on the first day of the first plan year beginning after the earlier of (1) the second anniversary of the date of adoption of the funding improvement plan, or (2) the expiration of collective bargaining agreements that were in effect on the due date for the actuarial certification of endangered status for the initial determination year and covering, as of such date, at least 75 percent of the plan's active participants. The period ends if the plan is no longer in endangered status or if the plan enters critical status.

In the case of a plan in seriously endangered status that is funded at 70 percent or less, under the applicable benchmarks, the difference between 100 percent and the plan's funded

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[114] This requirement applies for the initial determination year (that is, the first plan year that the plan is in endangered status). If a plan sponsor fails to adopt a funding improvement plan by the end of the 240-day period after the required certification date, an ERISA penalty of up to $1,100 a day applies.

percentage at the beginning of the period must be reduced by at least one-fifth during the funding improvement period. In the case of such plans, a 15-year funding improvement period is used.

In the case of a seriously endangered plan that is more than 70-percent funded as of the beginning of the initial determination year, the same benchmarks apply for plan years beginning on or before the date on which the last collective bargaining agreements in effect on the date for actuarial certification for the initial determination year and covering at least 75 percent of active employees in the multiemployer plan have expired if the plan actuary certifies within 30 days after certification of endangered status that the plan is not projected to attain the funding percentage increase otherwise required by the provision. Thus, for such plans, the difference between 100 percent and the plan's funded percentage at the beginning of the period must be reduced by at least one-fifth during the 15-year funding improvement period. For subsequent years for such plans, if the plan actuary certifies that the plan is not able to attain the increase generally required under the provision, the same benchmarks continue to apply.

If, for the first plan year following the close of the funding improvement period, the plan's actuary certifies that the plan is in endangered status, such year is treated as an initial determination year. Thus, a new funding improvement plan must be adopted within 240 days of the required certification date. In such case, the multiemployer plan may not be amended in a manner inconsistent with the funding improvement plan in effect for the preceding plan year until a new funding improvement plan is adopted.

In the case of a multiemployer plan in endangered status, but not seriously endangered status, a civil penalty of $1,100 a day may apply if the plan fails to meet the applicable benchmarks by the end of the funding improvement period. If a multiemployer plan in seriously endangered status fails to meet the applicable benchmarks by the end of the funding improvement period fails, for excise tax purposes (unless the excise tax is waived), the plan is treated as having a funding deficiency equal to (1) the amount of the contributions necessary to leave critical status or make scheduled progress or (2) the plan's actual funding deficiency, if any.

Rehabilitation plan

If a plan is in critical status for a plan year, the plan sponsor must adopt a rehabilitation plan within 240 days following the required date for the actuarial certification of critical status.[115] A rehabilitation plan is a plan that consists of actions, including options or a range of options to be proposed to the bargaining parties, formulated, based on reasonable anticipated experience and reasonable actuarial assumptions, to enable the plan to cease to be in critical status by the end of the rehabilitation period and may include reductions in plan expenditures (including plan mergers and consolidations), reductions in future benefits accruals or increases in

[115] The requirement applies with respect to the initial critical year. If a plan sponsor fails to adopt a rehabilitation plan within 240 days after the date required for certification, an ERISA penalty of $1,100 a day applies. In addition, upon the failure to timely adopt a rehabilitation plan, an excise tax is imposed on the plan sponsor equal to the greater of (1) the present law excise tax or (2) $1,100 per day.

contributions, if agreed to by the bargaining parties, or any combination of such actions.[116] A rehabilitation plan must provide annual standards (referred to as scheduled progress) for meeting the requirements of the rehabilitation plan. The plan must also include the schedules required to be provided to the bargaining parties, as discussed below. The plan sponsor must update the rehabilitation plan annually to reflect the circumstances of the multiemployer plan.

If the plan sponsor determines that, based on reasonable actuarial assumptions and upon exhaustion of all reasonable measures, the plan cannot reasonably be expected to emerge from critical status by the end of the rehabilitation period, the plan must include reasonable measures to emerge from critical status at a later time or to forestall possible insolvency. In such case, the plan must set forth alternatives considered, explain why the plan is not reasonable expected to emerge from critical status by the end of the rehabilitation period, and specify when, if ever, the plan is expected to emerge from critical status in accordance with the rehabilitation plan.

The rehabilitation period is generally the 10-year period beginning on the first day of the first plan year following the earlier of (1) the second anniversary of the date of adoption of the rehabilitation plan or (2) the expiration of collective bargaining agreements that were in effect on the due date for the actuarial certification of critical status for the initial critical year and covering at least 75 percent of the active participants in the plan.

The rehabilitation period ends if the plan emerges from critical status. A plan in critical status (that is, a plan that comes within any of the tests for critical status described previously) remains in critical status until a plan year for which the plan actuary certifies that the plan is not projected to have an accumulated funding deficiency for the plan year or any of the nine succeeding plan years, without regard to the use of the shortfall method and taking into account amortization period extensions.[117]

If a multiemployer plan fails to make scheduled progress under the rehabilitation plan for three consecutive years or fails to meet the requirements applicable to plans in critical status by the end of the rehabilitation period, for excise tax purposes (unless the excise tax is waived), the plan is treated as having a funding deficiency equal to (1) the amount of the contributions necessary to leave critical status or make scheduled progress or (2) the plan's actual funding deficiency, if any.

Excise tax on employers failing to make required contributions

If a funding improvement or rehabilitation plan requires an employer to make contributions to the multiemployer plan and the employer fails to make the contributions within

[116] Any benefit reductions under a multiemployer plan in critical are disregarded in determining an employer's withdrawal liability.

[117] Consistent with this rule, under Prop. Treas. Reg. sec. 1.432(b)-1(c), in order to emerge from critical status, a multiemployer plan must not come within any of the tests for critical status described previously and must receive the actuarial certification described above.

the time required under the plan, an excise tax (unless waived) applies to the employer in the amount of required contributions the employer failed to make.

Information to be provided to bargaining parties

Within 30 days of the adoption of a funding improvement or rehabilitation plan, the plan sponsor must provide to the bargaining parties schedules showing revised benefit structures, revised contribution structures, or both, which, if adopted, may reasonably be expected to enable the multiemployer plan to meet the applicable requirements under the funding improvement or rehabilitation plan.[118] Certain schedules of contributions and benefits are required to be provided to the bargaining parties and, in each case, a particular schedule must be designated as the default schedule under the funding improvement or rehabilitation plan.[119] The plan sponsor may provide the bargaining parties with additional information as it deems appropriate.

If a collective bargaining agreement providing for contributions under a multiemployer plan that was in effect at the time the plan entered endangered or critical status expires, and after receiving one or more schedules from the plan sponsor, the bargaining parties fail to agree on changes to contribution or benefit schedules necessary to meet the applicable benchmarks, the plan sponsor must implement the default schedule 180 days after the date on which the collective bargaining agreement expires.[120]

Additional rules for multiemployer plans in critical status

In the case of a multiemployer plan in critical status, if a rehabilitation plan is adopted and complied with, employers are not liable for contributions otherwise required under the general funding rules. In addition, the excise tax for failure to meet the funding requirements, that is, in the case of an accumulated funding deficiency, does not apply.

Certain plan contributions ("surcharges"), in addition to the contributions required under a collective bargaining agreement, apply to employers otherwise obligated to make a contribution in the first plan year for which the plan is in critical status. For that year, the surcharge is five percent of the contribution otherwise required to be made under the applicable collective bargaining agreement. The surcharge is 10 percent of contributions otherwise required in the case of succeeding plan years in which the plan is in critical status. The surcharge applies 30 days after the employer is notified by the plan sponsor that the plan is in critical status and the surcharge is in effect. The surcharges are due and payable on the same schedule as the contributions on which the surcharges are based. Failure to make the surcharge payment is treated as a delinquent contribution under a collective bargaining agreement. The surcharge is

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[118] The plan sponsor must annually update any schedule of contribution rates under a funding improvement or rehabilitation plan to reflect the experience of the multiemployer plan.

[119] A default schedule under a rehabilitation plan that includes reductions in future benefit accruals must not reduce the rate of benefit accruals below a specified minimum level.

[120] Present law does not provide for the plan sponsor to impose an updated default schedule if a bargaining impasse occurs with respect to a later bargaining cycle.

not required with respect to employees covered by a collective bargaining agreement (or other agreement pursuant to which the employer contributes), beginning on the effective date of a collective bargaining agreement (or other agreement) that includes terms consistent with a schedule presented by the plan sponsor. Surcharges may not be the basis for any benefit accrual under the plan, and surcharges are generally disregarded in determining an employer's withdrawal liability.

In the case of a multiemployer plan in critical status, subject to providing advance notice, the plan sponsor may make certain reductions to adjustable benefits that the plan sponsor deems appropriate. The adjustments are generally to be based upon the outcome of collective bargaining over the schedules required to be provided by the plan sponsor as discussed above. In addition, with respect to participants for whom contributions are not currently required to be made, the plan sponsor may reduce benefits to the extent legally permitted and considered appropriate by the plan sponsor based on the plan's then current overall funding status. However, benefits generally may not be reduced for a participant or beneficiary who began to receive benefits before receiving notice of the multiemployer plan's critical status.

Adjustable benefits means (1) benefits, rights, and features under the plan, including post-retirement death benefits, 60-month guarantees, disability benefits not yet in pay status, and similar benefits; (2) any early retirement benefit or retirement-type subsidy and any benefit payment option (other than the qualified joint-and-survivor annuity); and (3) benefit increase that would not be eligible for PBGC guarantee on the first day of the initial critical year because the increases were adopted (or, if later, took effect) less than 60 months before such first day. Adjustable benefits that are otherwise protected under the anti-cutback rules, such as early retirement benefits, retirement-type subsidies and optional forms of benefit, may be reduced notwithstanding the anti-cutback rules. However, the level of a participant's accrued benefit payable at normal retirement age may not be reduced. Adjustable benefit reductions are disregarded in determining an employer's withdrawal liability.

No adjustable benefits may be reduced unless 30 days advance notice is given plan participants and beneficiaries, any employer that has an obligation to contribute to the plan, and any employee organization which, for purposes of collective bargaining, represents plan participants employed by such an employer. The notice must contain sufficient information to enable participants and beneficiaries to understand the effect of any reduction of their benefits, including an estimate (on an annual or monthly basis) of any affected adjustable benefit that a participant or beneficiary would otherwise have been eligible for, and information as to the rights and remedies of plan participants and beneficiaries as well as how to contact DOL for further information and assistance where appropriate.

Sunset of endangered and critical rules

The rules relating to endangered and critical status generally do not apply to plan years beginning after December 31, 2014.[121] However, if a multiemployer plan is operating under a

[121] Sec. 221(c) of PPA.

funding improvement or rehabilitation plan for its last plan year beginning before January 1, 2015, that is, for its 2014 plan year, the multiemployer plan must continue to operate under the funding improvement or rehabilitation plan during any period after December 31, 2014, that the funding improvement or rehabilitation plan is in effect, and all of the Code and ERISA provisions relating to the operation of the funding improvement or rehabilitation plan continue in effect during that period.

Deduction limit

The deduction limit for employer contributions to a multiemployer plan is generally the excess of (1) 140 percent of the plan's current liability (the present value of all benefits earned under the plan), over (2) the value of plan assets. This limit applies to the total contributions made by all employers participating in the multiemployer plan.

State of the multiemployer defined benefit plan system

Many multiemployer defined benefit plans are funded at levels considered sufficient to provide plan benefits over time. However, some plan are experiencing severe funding problems. Some plans are already insolvent and receiving financial assistance from the PBGC. Others are likely to become insolvent in the near term. The PBGC indicates that multiemployer plans covering more than 10 percent of participants are at serious risk.[122] Further, the PBGC projects that assets associated with its multiemployer program are more likely than not to be exhausted by the end of 2022.[123] In that case, although the PBGC will continue to receive annual premiums from multiemployer plans, at present-law premium rates, annual premiums will not be sufficient to provide multiemployer plan benefits covered by the PBGC guarantee.

The endangered and critical rules enacted under PPA were intended to require multiemployer plan sponsors, contributing employers, participants and bargaining party representatives to address funding problems, as well as to provide additional measures to address the problems. In the case of plans in critical status, PPA allows the reduction or elimination of retirement benefits that would otherwise be protected under the anti-cutback rules and suspends the excise tax that would apply to employers in the case of a funding deficiency. These measures have been used effectively for some plans, with a resulting improvement in funded status for those plans.[124] However, the condition of some plans has worsened and participant benefits are at even greater risk than when PPA was enacted.[125]

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[122] PBGC news release of June 30, 2014, accompanying its *FY 2013 Projections Report*, available at http://www.pbgc.gov/news/press/releases/pr14-08.html.

[123] *PBGC FY 2013 Projections Report*, "Will PBGC Have Funds to Pay Multiemployer Guarantees?" (pp. 13-14), available at http://www.pbgc.gov/documents/Projections-report-2013.pdf.

[124] See, for example, *Multiemployer Pension Plans, Report to Congress Required by the Pension Protection Act of 2006*, issued January 22, 2013, available at http://www.pbgc.gov/documents/pbgc-report-multiemployer-pension-plans.pdf.

[125] The 2008-2009 economic downturn contributed to the fiscal difficulties of many plans.

Some have proposed fundamental structural changes to the multiemployer rules, including giving plan sponsors the authority to reduce protected benefits (within limits) before plan insolvency.[126] Proponents suggest this will enable plans sponsors to avert insolvency and the more severe benefit losses experienced by participants in insolvent plans. Others believe that expanding plan sponsors' authority to reduce benefits should be a last resort, only after all alternatives approaches have been explored.

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[126] *Solutions, Not Bailouts, A Report on the Proceedings, Findings and Recommendations of the Retirement Security Review Commission of the National Coordinating Committee for Multiemployer Plans* (NCCMP), issued February 2012, available at http://www.nccmp.org/forEmails/SolutionsNotBailouts.pdf.

E. Pension Benefit Guaranty Corporation

1. In general

The minimum funding requirements permit an employer to fund defined benefit plan benefits over a period of time. Thus, it is possible that a plan may be terminated at a time when plan assets are not sufficient to provide all benefits earned by employees under the plan. In order to protect plan participants and beneficiaries from losing retirement benefits in such circumstances, the PBGC, a corporation within DOL, was created under ERISA to provide an insurance program for benefits under most defined benefit plans maintained by private employers.[127]

ERISA provides that the PBGC is administered by a director, who is appointed by the President of the United States by and with the advice and consent of the Senate. The director must act in accordance with policies established by the board of directors of the PBGC. The composition of the board of directors is specified under ERISA as the Secretary of the Treasury, the Secretary of Labor, and the Secretary of Commerce. The Secretary of Labor is the chairman of the board of directors.

The PBGC is financed through the payment of premiums by covered defined benefit plans, assets from terminated single-employer defined benefit plans trusteed by the PBGC, and investment income on PBGC assets. The PBGC insures pension benefits under separate programs, one for single-employer defined benefit plans and the other for multiemployer defined benefit plans.[128]

2. Single-Employer Plan Program

Premiums

In the case of a single-employer defined benefit plan, flat-rate premiums apply for 2014 at a rate of $49 per participant. The per-participant rate is scheduled to be $57 for 2015 and, after indexing, is expected to be $64 for 2016, with indexing thereafter.

If a single-employer defined benefit plan has unfunded vested benefits, variable-rate premiums also apply for 2014 at a rate of $14 per $1,000 of unfunded vested benefits divided by the number of participants, subject to a cap of $412 per participant for 2014 with indexing thereafter. After indexing, the rate for variable-rate premiums is expected to be $24 per $1,000 of unfunded vested benefits for 2015 and $29 for 2016 with indexing thereafter. For purposes of

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[127] ERISA secs. 4001-4071. Governmental and church plans are generally not covered by the PBGC insurance programs.

[128] Multiple-employer defined benefit plans are covered by the PBGC insurance program for single-employer plans. PBGC insurance coverage does not apply to nonqualified deferred compensation plans or to certain private qualified defined benefit plans maintained exclusively for substantial owners of the employer sponsoring the plan or maintained by a professional service employer that at no time has more than 25 active participants.

determining variable-rate premiums, unfunded vested benefits are equal to the excess (if any) of (1) the plan's funding target for the year determined as under the minimum funding rules, but taking into account only vested benefits, over (2) the fair market value of plan assets. In determining the plan's funding target for this purpose, the interest rates used are segment rates determined as under the minimum funding rules, but determined on a monthly basis, rather than using a 24-month average of corporate bond rates and without adjustments for 25-year average rates.

Plan terminations

An employer may voluntarily terminate a single-employer plan only in a standard termination or a distress termination.[129] The participants and the PBGC must be provided notice of the intent to terminate. The PBGC may also involuntarily terminate a plan (that is, the termination is not voluntary on the part of the employer).

A standard termination is permitted only if plan assets are sufficient to cover benefit liabilities. Generally, benefit liabilities equal all benefits earned to date by plan participants, including vested and nonvested benefits (which automatically become vested at the time of termination), and including certain early retirement supplements and subsidies.[130] Benefit liabilities may also include certain contingent benefits (for example, early retirement subsidies). If assets are sufficient to cover benefit liabilities (and other termination requirements, such as notice to employees, have not been violated), the plan distributes benefits to participants. The plan provides for the benefit payments it owes by purchasing annuity contracts from an insurance company, or otherwise providing for the payment of benefits, for example, by providing the benefits in lump-sum distributions.

If certain requirements are satisfied, and the plan so provides, assets in excess of the amounts necessary to cover benefit liabilities may be recovered by the employer in an asset reversion. Reversions are subject to an excise tax, described above.

Distress terminations and involuntary terminations by the PBGC

Distress terminations

If assets in a defined benefit plan are not sufficient to cover benefit liabilities, the employer may not terminate the plan unless the employer meets one of four criteria necessary for a ''distress'' termination:

- The contributing sponsor, and every member of the controlled group of which the sponsor is a member, is being liquidated in bankruptcy or any similar Federal law or other similar State insolvency proceedings;

[129] ERISA sec. 4041.

[130] ERISA sec. 4001(a)(16).

- The contributing sponsor and every member of the sponsor's controlled group is being reorganized in bankruptcy or similar State proceeding;
- The PBGC determines that termination is necessary to allow the employer to pay its debts when due; or
- The PBGC determines that termination is necessary to avoid unreasonably burdensome pension costs caused solely by a decline in the employer's work force.[131]

<u>Involuntary terminations by the PBGC</u>

The PBGC may institute proceedings to terminate a plan if it determines that the plan in question has not met the minimum funding standards, will be unable to pay benefits when due, has a substantial owner who has received a distribution greater than $10,000 (other than by reason of death) while the plan has unfunded nonforfeitable benefits, or may reasonably be expected to increase PBGC's long-run loss unreasonably. The PBGC must institute proceedings to terminate a plan if the plan is unable to pay benefits that are currently due.[132]

<u>Asset allocation</u>

ERISA contains rules for allocating the assets of a single-employer plan when the plan terminates.[133] Plan assets available to pay for benefits under a terminating plan include all plan assets remaining after subtracting all liabilities (other than liabilities for future benefit payments), paid or payable from plan assets under the provisions of the plan. On termination, the plan administrator must allocate plan assets available to pay for benefits under the plan in the manner prescribed by ERISA. In general, plan assets available to pay for benefits under the plan are allocated to six priority categories. If the plan has sufficient assets to pay for all benefits in a particular priority category, the remaining assets are allocated to the next lower priority category. This process is repeated until all benefits in the priority category are provided or until all available plan assets have been allocated.[134]

<u>Payment of benefits</u>

<u>In general</u>

When a plan terminates in a distress termination and assets are sufficient to pay guaranteed benefits, the plan pays out benefits. When an underfunded plan terminates in a distress or involuntary termination and benefits are insufficient to pay guaranteed benefits, the plan becomes the responsibility of the PBGC. The PBGC becomes the trustee of the plan, takes

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[131] ERISA sec. 4041.

[132] Rather than initiate an involuntary plan termination, the PBGC may instead enter into an agreement with the plan sponsor, under which the plan sponsor is required to make additional contributions to the plan or maintain the plan's funded status at a certain level.

[133] ERISA sec. 4044(a).

[134] The asset allocation rules also apply in standard terminations.

control of any plan assets, and assumes responsibility for liabilities under the plan. The PBGC makes payments for benefits promised under the plan with assets received from two sources: assets in the plan before termination, and assets recovered from the employer. The balance, if any, of guaranteed benefits owed to beneficiaries is paid from other funds associated with the single-employer program.

Guarantee levels

When an underfunded plan terminates, the amount of benefits that the PBGC will pay depends on legal limits, asset allocation, and recovery on the PBGC's employer liability claim. The PBGC guarantee applies to "basic benefits." Basic benefits generally are vested benefits accrued before a plan terminates, including (1) benefits at normal retirement age; (2) most early retirement benefits; (3) disability benefits for disabilities that occurred before the plan was terminated; and (4) certain benefits for survivors of plan participants. Generally only that part of the retirement benefit that is payable in monthly installments (rather than, for example, lump-sum benefits payable to encourage early retirement) is guaranteed.[135]

Retirement benefits that begin before normal retirement age are guaranteed, provided they meet the other conditions of guarantee (such as that before the date the plan terminates, the participant had satisfied the conditions of the plan necessary to establish the right to receive the benefit other than application for the benefit). Contingent benefits (for example, subsidized early retirement benefits) are guaranteed only if the triggering event occurs before plan termination.

In the case of a single-employer plan, the PBGC guarantee limit is the indexed dollar amount applicable for the year of plan termination and applies to annuity benefits commencing at age 65, with a reduced or increased limit for earlier or later commencement. For plans terminating in 2014, the guarantee limit is $59,320 for benefits commencing at age 65.

In the case of a plan or a plan amendment that has been in effect for less than five years before a plan termination, the amount guaranteed is generally phased in by 20 percent a year.

Employer liability to the PBGC

Additionally, following a distress or involuntary termination, the plan's contributing sponsor and every member of that sponsor's controlled group is liable to the PBGC for the excess of the value of the plan's liabilities as of the date of plan termination over the fair market value of the plan's assets on the date of termination.[136] The liability is joint and several, meaning that each member of the controlled group can be held responsible for the entire liability. Generally, the obligation is payable in cash or negotiable securities to the PBGC on the date of termination. Failure to pay this amount upon demand by the PBGC may trigger a lien on the property of the contributing employer's controlled group for up to 30 percent of its net worth.

[135] ERISA sec. 4022(b) and (c).

[136] ERISA sec. 4062.

Obligations in excess of this amount are to be paid on commercially reasonable terms acceptable to the PBGC.

Substantial cessation of operations

Certain funding-related requirements apply if a substantial cessation of operations occurs in connection with a single-employer defined benefit plan.[137] For this purpose, a substantial cessation of operations occurs if the employer maintaining the plan ceases operations at a facility, for example, closes a plant, and, as a result, more than 20 percent of the total active participants in the plan are separated from employment.

If a substantial cessation of operations occurs, the employer is required to pay to the PBGC a portion of the unfunded benefit liabilities under the plan (determined in the same manner as if the plan were terminating), which the PBGC then holds in escrow. Alternatively, the employer can provide a bond for 150 percent of the amount it would otherwise have to pay to the PBGC.

The escrow or bond is released after five years if the defined benefit plan is not terminated during that time. If the plan is terminated within five years, the escrow or bond proceeds are used to fund the plan as needed for termination, with any remaining amounts returned to the employer.

The PBGC also has authority to make other arrangements with the employer, rather than requiring the payment to the PBGC or the bond.

On July 8, 2014, the PBGC announced a moratorium, until December 31, 2014, on enforcement action with respect to substantial cessations of operations.[138]

3. Multiemployer Plan Program

Premiums

In the case of a multiemployer plan, flat-rate premiums apply at a rate of $12 per participant for 2014 with indexing thereafter.

Guarantee

In the case of multiemployer plans, the PBGC insures plan insolvency, rather than plan termination. Accordingly, a multiemployer plan need not be terminated to qualify for PBGC financial assistance, but must be found to be insolvent. A plan is insolvent when its available resources are not sufficient to pay the plan benefits for the plan year in question, or when the

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[137] ERISA sec. 4062(e), under which the rules of ERISA section 4063 (which generally deal with the withdrawal of an employer from a multiple-employer plan) apply.

[138] PBGC Issues Moratorium on 4062(e) Enforcement, available at http://www.pbgc.gov/news/press/releases/pr14-09.html.

sponsor of a plan in reorganization reasonably determines, taking into account the plan's recent and anticipated financial experience, that the plan's available resources will not be sufficient to pay benefits that come due in the next plan year. If it appears that available resources will not support the payment of benefits at the guaranteed level, the PBGC will provide the additional resources needed as a loan, referred to as financial assistance. The PBGC may provide loans to the plan for multiple years. If the plan recovers from insolvency, it must begin repaying loans on reasonable terms in accordance with regulations.

The PBGC generally guarantees vested benefits under a multiemployer plan of the same type as those guaranteed under a single-employer plan, but a different guarantee ceiling applies.[139] The limit for multiemployer plans is the sum of 100 percent of the first $11 of monthly benefits and 75 percent of the next $33 of monthly benefits for each year of service.[140]

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[139] In the case of a multiemployer plan, the PBGC guarantees QPSA benefits only in the case of a surviving spouse of a participant who dies before plan termination.

[140] ERISA sec. 4022A(c).

II. DATA RELATING TO RETIREMENT PLANS

A. General Data on Retirement Plan Participation

According to the National Compensation Survey (NCS),[141] in 2014, 65 percent of U.S. workers employed in the private sector had access to a qualified retirement plan and 48 percent of workers employed in the private sector participated in a qualified retirement plan. This translates to a take-up rate of 75 percent, meaning 75 percent of those with access participated. Take-up rates were stable at 75 or 76 percent over the four year period, 2011 to 2014. These take-up rates indicate that while a large percentage of employees participate in an employer plan if available to them, some employees do not.

Table 1.–Retirement benefits: Access, Participation and Take-Up Rates in the Private Sector (percentage of all workers)

Year	Access	Employee Participation[1]	Take-Up Rate[2]
2011	64	49	76
2012	65	48	75
2013	64	49	76
2014	65	48	75

Source: Bureau of Labor Statistics, National Compensation Survey Data, 2011-2014.
Notes: All workers = 100 percent. Rates are rounded to the nearest percent. As a result, take-up rates may not be exactly equal to the employee participation rate divided by the access rate as presented in this table.
[1] The employee participation rate is the percentage of employees (out of all private sector employees) who chose to participate in the plan.
[2] The take-up rate is the percentage of employees (out of all private sector employees with access) who chose to participate in the plan.

Figure 1 below shows that the number of participants in private-sector single-employer defined contribution plans has consistently increased since at least 1975 and up to 2011, while the number of participants in private-sector single-employer defined benefit plans has held steady over this same period. Both defined contribution and defined benefit plan participation rates have remained steady for those in multiemployer plans. Almost all of the total rise in plan participation over this period can be attributed to the increase in private-sector single-employer defined contribution plan participation.

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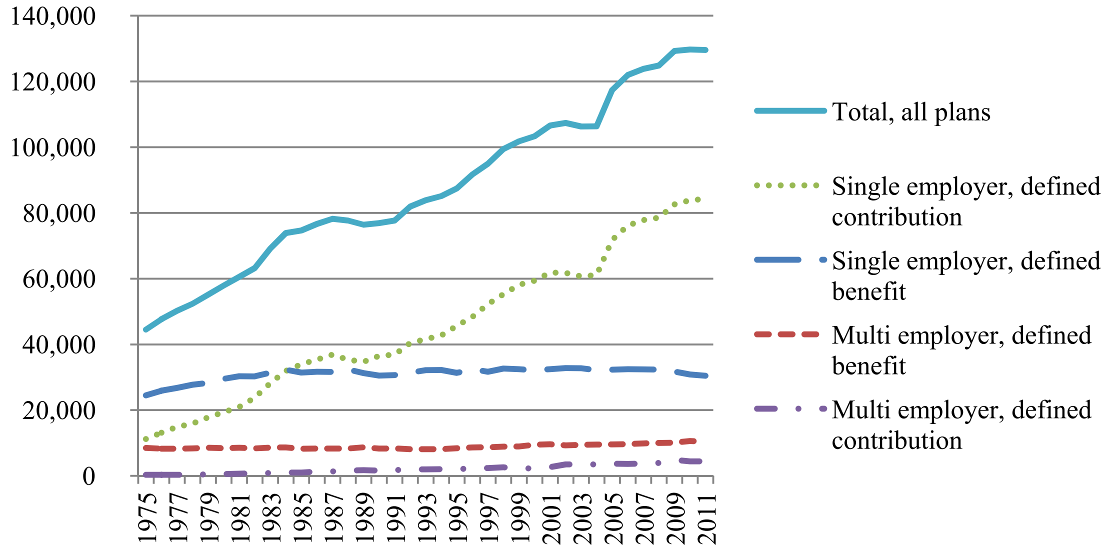
[141] The National Compensation Survey (NCS) is an annual survey conducted by the U.S. Department of Labor, Bureau of Labor Statistics (BLS). Each release contains data on civilian, private industry, and State and local government workers in the United States. Excluded are federal government workers, the military, agricultural workers, private household workers, and the self-employed.

Figure 1.−Number of Private-Sector Plan Participants by Type of Plan 1975-2011 (thousands)



Source: Form 5500 filings with the U.S. Department of Labor.
Note: The term "Participants" refers to active, retired, and separated vested participants not yet in pay status. The number of participants also includes double counting of workers in more than one plan. For Form 5500 Short Form filers, this number may also include deceased participants whose beneficiaries are receiving or are entitled to receive benefits. Excludes plans covering only one participant.

Table 2 shows the percentage of households in 2010 with an IRA balance, defined contribution account balance or a defined benefit pension. These data show that married households are more likely to have retirement savings in the form of IRA, defined contribution, and defined benefit accounts than single households.

Table 2 also shows that a greater percentage of older households have defined benefit pensions relative to defined contribution accounts and a greater percentage of younger households have defined contribution accounts relative to defined benefit pensions. This is consistent with an overall decline in defined benefit pension plan coverage over the past few decades, and a concurrent increase in defined contribution plan coverage.[142]

[142] See, for example, Barbara A. Butrica, Karen Elizabeth Smith, and Eric Toder *et al.*, *The Disappearing Defined Benefit Pension and its Potential Impact on the Retirement Incomes of Boomers,* Center for Retirement Research, January 2, 2009.

Table 2.−Percentage of Households in 2010 with an IRA Balance, DC Account Balance, or a Defined Benefit Pension, By Age Category

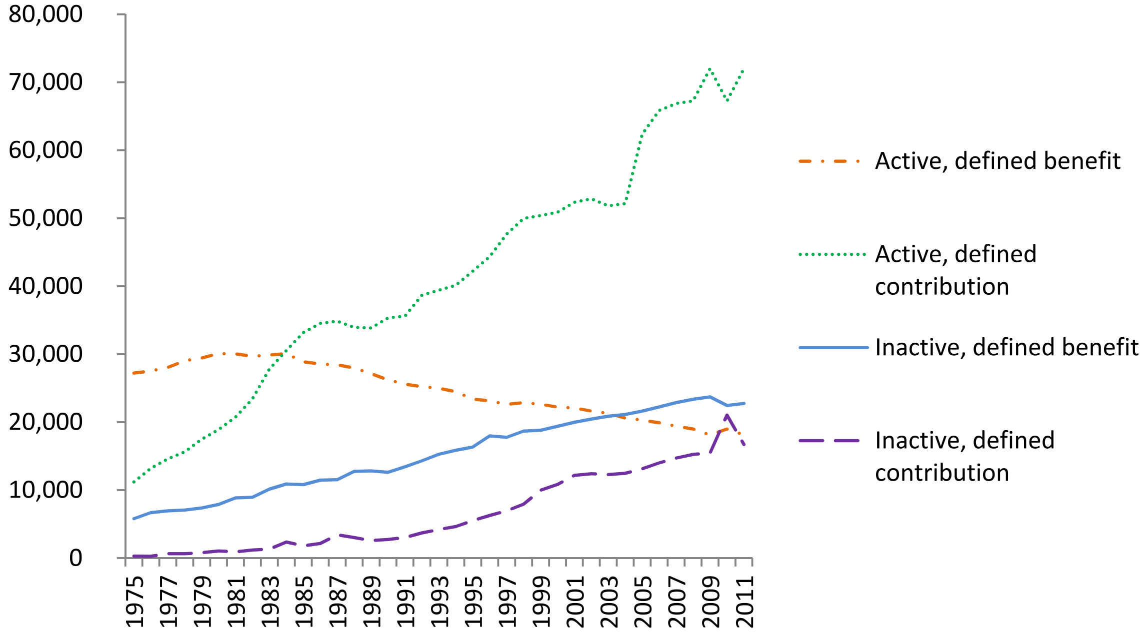
Single Household				Married Household			
Age	IRA	DC	DB	Age	IRA	DC	DB
<35	10.3	24.0	7.8	<35	17.1	39.6	16.6
35 − 44	13.9	30.4	14.2	35 − 44	25.8	49.5	22.6
45 − 54	19.9	29.5	21.4	45 − 54	33.5	52.7	32.8
55 − 64	30.3	21.1	32.0	55 − 64	48.8	43.3	46.0
65 − 74	25.6	3.0	42.0	65 − 74	50.1	16.4	49.9
75+	22.0	0.8	52.9	75+	43.5	3.5	62.4

Source: Congressional Research Survey, *U.S. Household Savings for Retirement in 2010.* Analysis of the 2010 Survey of Consumer Finances.
Note: Percentages represent percentages of households that had the type of plan at the time of the survey. Households may have had more than one type of plan.

Figure 2 below shows trends from 1975 to 2011 in the number of participants by active and inactive status. Active participants are current employees who participate in an employer's retirement plan. Inactive participants are former employees who still have an accrued benefit or account balance under an employer's retirement plan, including retirees receiving benefits. The numbers of inactive participants in defined benefit and defined contribution plans both increased over this period, though there are larger numbers of inactive participants in defined benefit plans than defined contribution plans throughout. Between 1975 and 2011, the number of active participants in defined benefit plans decreased and the number of active participants in defined contribution plans increased. The percent of active participants in defined benefit plans relative to active participants in defined contribution plans declined relatively sharply over this period.

The data in Figure 2 also show that a decreasing proportion of defined benefit participants are active participants (and an increasing proportion of defined benefit participants are inactive). Consistent with overall patterns, an increasing proportion of defined contribution participants are active participants (and a decreasing proportion of defined contribution participants are inactive).

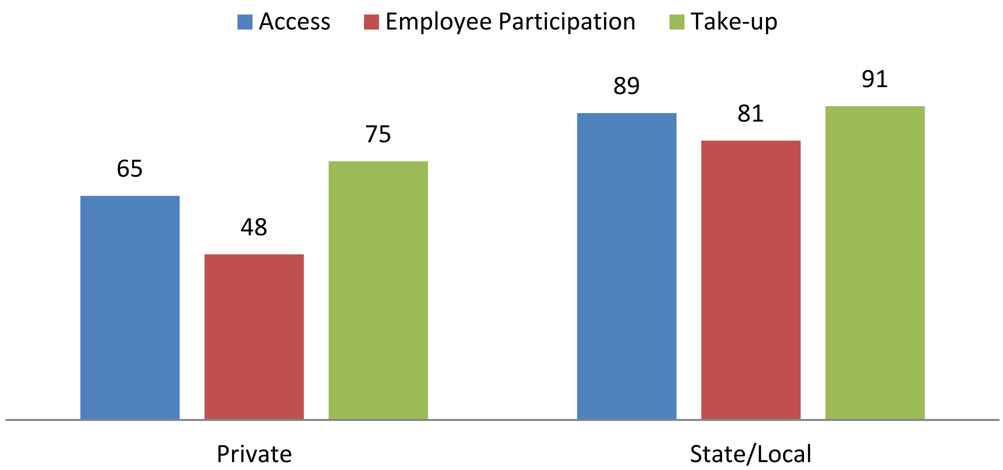
Figure 2.−Number of Private-Sector Participants by Active or Inactive Status and Type of Plan 1975-2011 (thousands)



Source: Form 5500 filings with the U.S. Department of Labor.

Rates of access and participation in qualified retirement plans vary by a number of worker and industry characteristics. Figure 3 shows that access rates are lower in the private sector than they are in the State and local government sector. In addition, rates of employee participation are lower in the private sector than in the government sector. As a result, the take-up rate in the private sector is 75 percent compared to a 91 percent take-up rate in the State and local government sector.

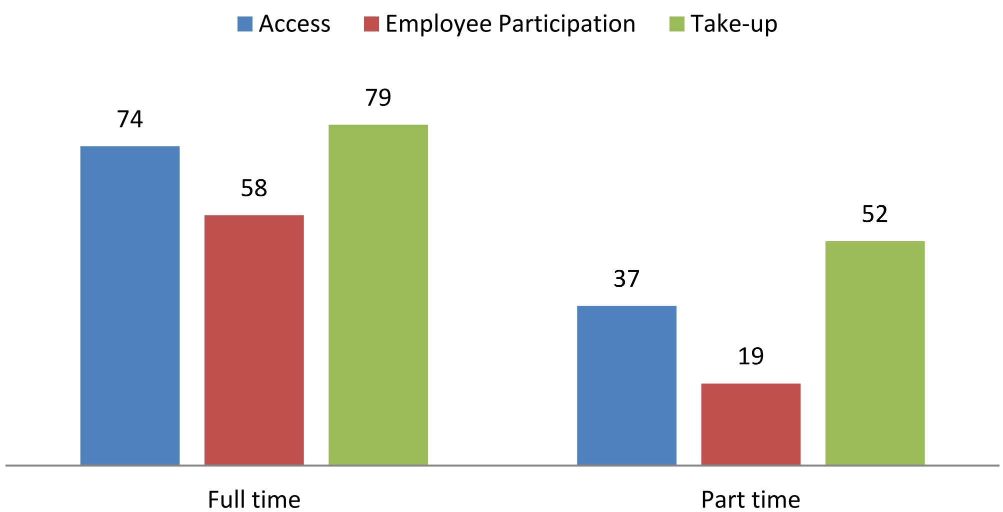
Figure 3.−Access, Participation, and Take-up Rates by Sector in 2014 (percentage)



Source: Bureau of Labor Statistics, National Compensation Survey Data, 2014.
Note: All workers=100 percent.

The data in Figure 4 show that access, employee participation, and take-up rates are significantly higher for full time workers than for part time ones. Overall take-up rates are only 52 percent for part time workers, compared to a 79 percent take-up rate for full time workers.

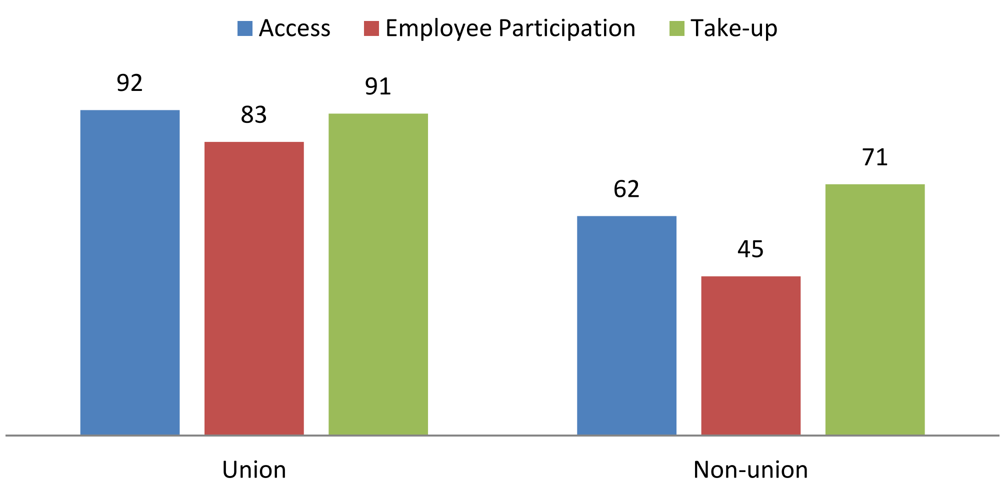
Figure 4.−Access, Participation, and Take-up Rates in the Private Sector by Full-time Status in 2014 (percentage)



Source: Bureau of Labor Statistics, National Compensation Survey Data, 2014.
Note: All workers=100 percent.

There is also a disparity in take-up rates between union and non-union workers. As shown in Figure 5, access, participation, and take-up rates are significantly higher for union workers than they are for non-union workers.

Figure 5.−Access, Participation, and Take-up Rates in the Private Sector by Union Status in 2014 (percentage)



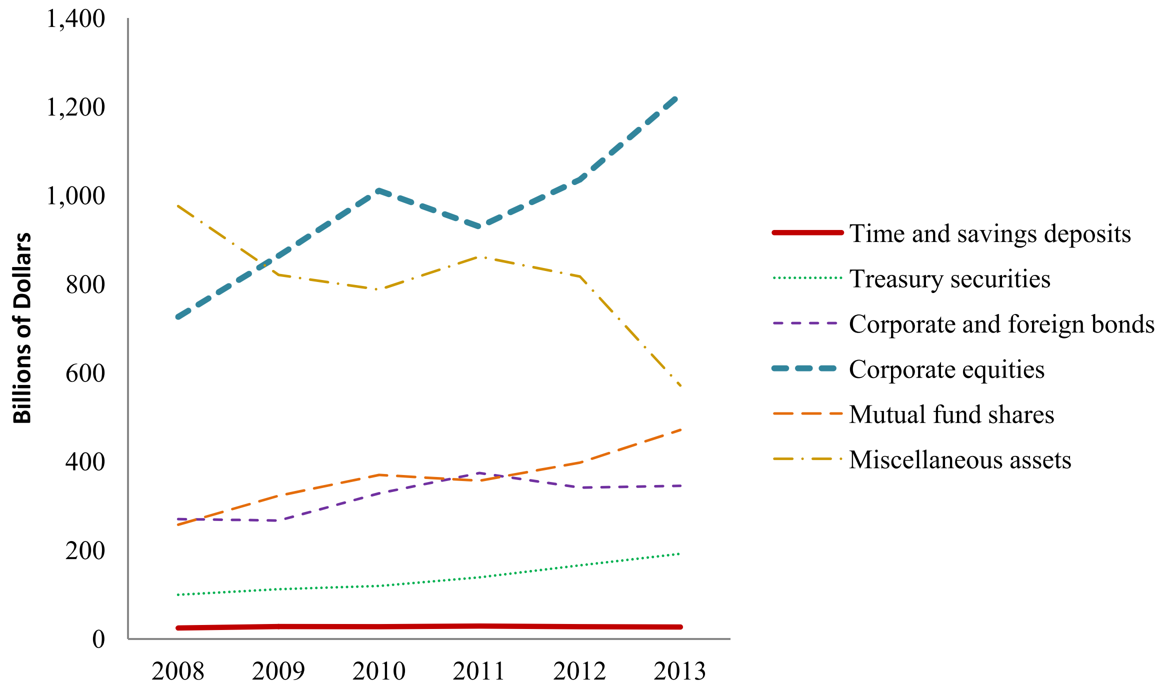
Source: Bureau of Labor Statistics, National Compensation Survey Data, 2014.
Note: All workers=100 percent.

B. Data on Retirement Plan Assets

Data from the Board of Governors of the Federal Reserve, Flow of Funds Accounts show a selection of some of the types of assets held in qualified retirement plans. Other financial assets held in qualified retirement plans include checkable deposits and currency; money market fund shares; security repurchase agreements; open market paper; agency and GSE-backed securities; mortgages; and mutual fund shares.

Figure 6 below shows a large share of assets in private defined benefit plans are held in corporate equities, with smaller holdings of Treasury securities, time and savings deposits, and corporate and foreign bonds. In 2013, the total value of assets held in private defined benefit plans was $3,068.5 billion. Of these total assets, 40 percent were in corporate equities. The data show that the value of holdings of corporate equities have increased at a moderate to rapid rate since 2008.

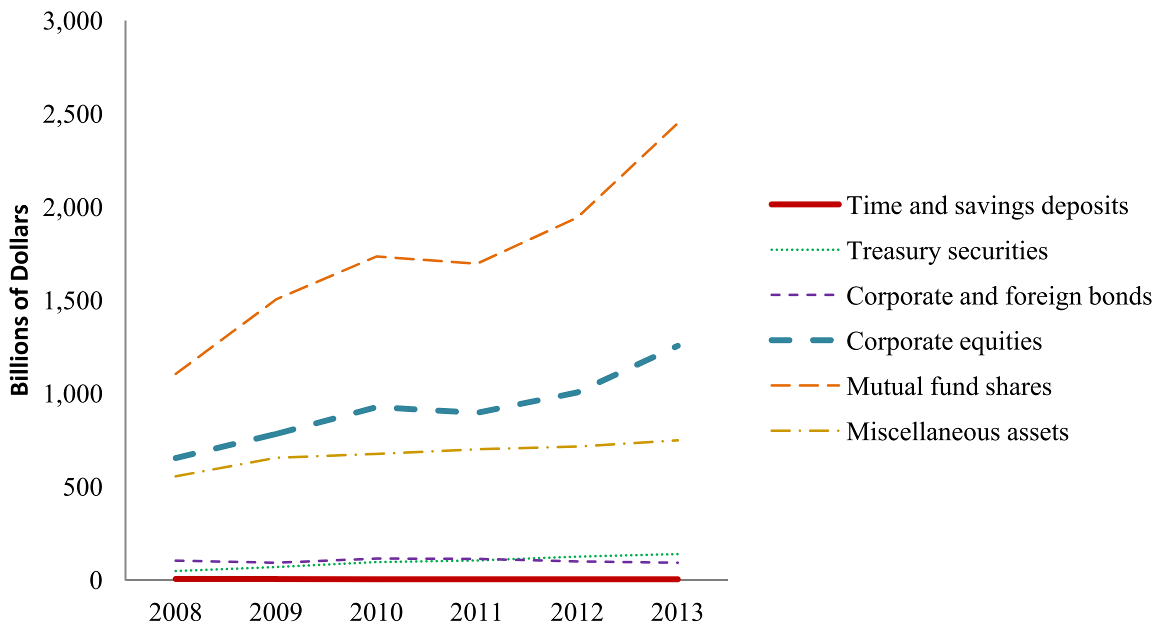
Figure 6.– Selected Assets Held in Private Defined Benefit Plans (billions of dollars)



Source: Board of Governors, Federal Reserve, Flow of Funds Accounts, 2014.
Note: Miscellaneous assets include unallocated insurance contracts; contributions receivable; claims of pension fund on sponsor; and others.

In contrast to private defined benefit plans, Figure 7 below shows the largest share of assets in private defined contribution plans is held in mutual fund shares. In 2013, the total value of assets held in defined contribution plans was $4,905.1 billion. In 2013, 49.9 percent of this total value was held in mutual funds. Corporate equities also represent a significant share of holdings. In 2013, corporate equities constituted 25.6 percent of total holdings. There are smaller holdings of other miscellaneous assets in private defined contribution plans, and nominal holdings of time and savings deposits and Treasury securities.

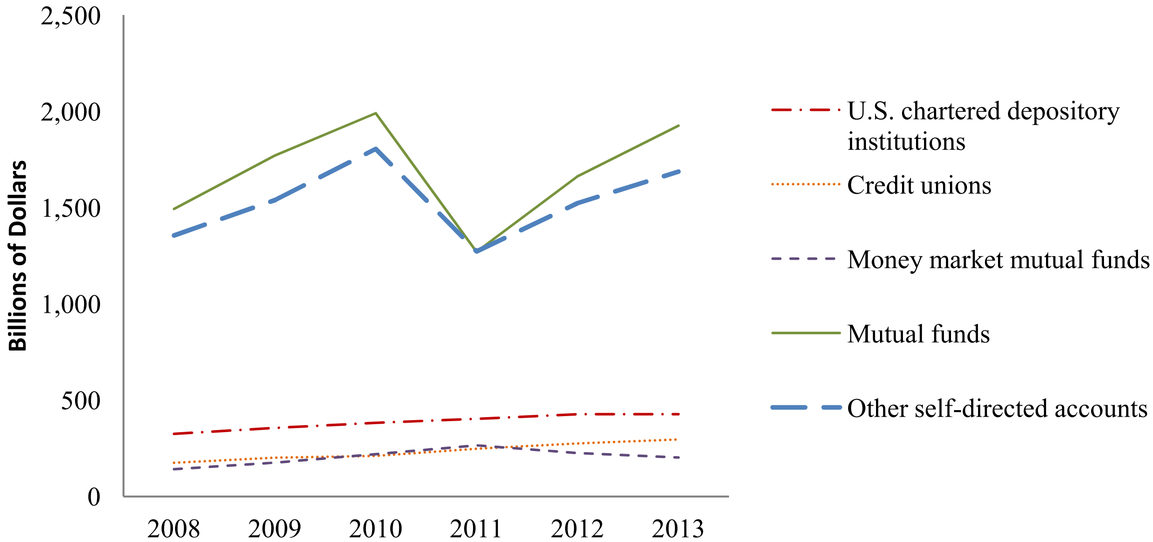
Figure 7.− Selected Assets Held in Private Defined Contribution Plans (billions of dollars)



Source: Board of Governors, Federal Reserve, Flow of Funds, 2014.
Note: Miscellaneous assets include unallocated insurance contracts; contributions receivable; claims of pension fund on sponsor; and others.

According to the data in Figure 8 below, the largest share of assets held in IRAs are in mutual funds and other self-directed accounts. The market value of IRA assets held in money market mutual funds and commercial banking are also significant though much smaller than the market value of IRA assets held in mutual funds and other self-directed accounts.

Figure 8.−Value of IRA Assets Held in Selected Financial Institutions (billions of dollars)



Source: Board of Governors, Federal Reserve, Flow of Funds, 2014.

Figure 9 below shows the market value of assets held in private defined contribution plans is consistently higher than those held in private defined benefit plans since at least 2008. Market value in IRAs and defined contribution plans exhibited modest to rapid growth since 2008. Assets held in defined benefit plans also exhibited growth, though this growth was more modest than in the defined contribution plans. As of December 31, 2013,[143] total assets held in private defined benefit plans was $3,068.5 billion; in private defined contribution plans was $4,905.1 billion; and in IRAs was $6,521.0 billion.

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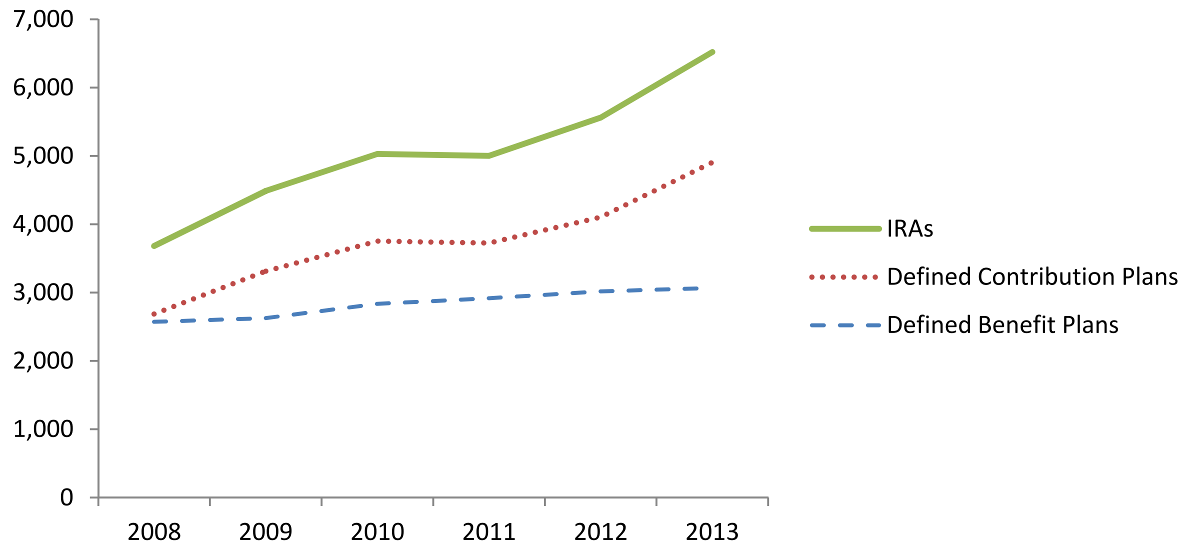
[143] This is the most recent year for which data on financial assets held in IRAs is available.

Figure 9.−Market Value of Holdings in Private Qualified Retirement Plans, By Type of Plan, and IRAs (billions of dollars)



Source: Board of Governors, Federal Reserve, Flow of Funds, 2014.

C. Data on Funded Status of Defined Benefit Plans and Status of PBGC Programs

Below is information about the funded status of single-employer and multiemployer defined benefit plans insured by the PBGC. Information about PBGC-insured single-employer and multiemployer plans and their funded status is taken from PBGC Pension Insurance Data Tables 2013.[144]

1. Single-employer plans covered by the PBGC insurance program

Table 3 presents data on the total number of single employer plans that are covered by the PBGC and the total number of insured participants in these plans. Not all single-employer defined benefit plans are insured by the PBGC. For example, PBGC coverage does not apply to most governmental or church plans or plans covering only business owners and spouses.

Table 3.−Number of Single-Employer Plans and Participants as of 2013

Total Insured Plans	Total Insured Participants
23,399	31,900,000

Source: PBGC premium filings.
Note: Figures are estimates from PBGC internal calculations.

Tables 4, 5, and 6 contain information on the estimated levels of aggregate underfunding and overfunding as well as total assets and liabilities for all PBGC covered single-employer plans; all PBGC covered single-employer plans that are underfunded; and all PBGC covered single-employer plans that are overfunded, respectively.

Table 4.−Estimated Aggregate Funding for 2011 of Single-Employer Plans

Assets	Liabilities	Aggregate Funding Ratio	Aggregate Underfunding in Underfunded Plans	Aggregate Overfunding in Overfunded Plans
$2,019,906,000,000	$2,377,262,000,000	85%	$396,346,000,000	$38,990,000,000

Source: PBGC 2012 Data Book Tables. These derive from Form 5500 filings.[1]
[1] Form 5500 (Annual Return/Report of Employee Benefit Plan) is filed with the Department of Labor (DOL) and fulfills reporting requirements under the Code and ERISA.

[144] Available at http://www.pbgc.gov/Documents/pension-insurance-data-tables-2011.pdf. Notes in the relevant PBGC source tables describe the interest and mortality assumptions used in determining vested liabilities.

Table 5.−Estimated Aggregate Funding for 2011 of Underfunded Single-Employer Plans

Assets	Liabilities	Aggregate Funding Ratio	Aggregate Underfunding in Underfunded Plans
$1,694,339,000,000	$2,090,685,000,000	81%	$396,346,000,000

Source: Form 5500 filings

Table 6.−Estimated Aggregate Funding for 2011 of Overfunded Single-Employer Plans

Assets	Liabilities	Aggregate Funding Ratio	Aggregate Overfunding in Overfunded Plans
$325,567,000,000	$286,577,000,000	114%	$38,990,000,000

Source: Form 5500 filings

Table 7 displays data on the distribution of underfunded amounts across employers. The table shows that the 10 plans with the highest levels of underfunding together account for 14.9 percent of aggregate levels of underfunding. The next 40 plans with highest underfunding account for another 17.1 percent of aggregate levels of underfunding. In 2011, 18,926 single employer plans were covered by the PBGC and were underfunded. Of these, the 50 plans with the highest levels of underfunding accounted for 32.1 percent of the total underfunding.

Table 7.−Estimated Concentration of 2011 Underfunding in Single-Employer Plans

Plans	Underfunding Amount	Percentage of Total Underfunding
All plans	$396,346,000,000	100%
10 plans with highest underfunding	$59,146,000,000	14.9%
Next 40 plans with highest underfunding	$67,937,000,000	17.1%
All other plans	$269,263,000,000	67.9%

Source: Form 5500 filings.

Table 8 presents data on the financial condition of the PBGC's single-employer program. As of September 30, 2013, total liabilities exceeded total assets by approximately $27.4 billion.

Table 8.−PBGC Financial Condition as of September 30, 2013, Single-Employer Plan Program[1]

Item	Amount
Total Assets	$83,227,000,000
Total Liabilities	$110,608,000,000[2]
Net position	($27,381,000,000)

[1] Pension Benefit Guaranty Corporation FY 2013 Annual Report ("PBGC 2013 Annual Report").

[2] Total liabilities under the single-employer program include the present value of future benefits to be paid by PBGC. The factors and method used in determining this item are explained in Note 6 of the PBGC 2012 Annual Report, pp. 73-77. The present value of future benefits includes an amount attributable to claims for probable terminations in the future of single-employer plans for which PBGC would assume responsibility. Probable terminations represent PBGC's best estimate of claims for plans that are likely to terminate in a future year.

2. Multiemployer plans

Table 9 presents data on the total number of single employer plans that are covered by the PBGC and the total number of insured participants in these plans. All multiemployer plans are insured by the PBGC.

Table 9.−Number of Multiemployer Plans and Participants as of 2013

Number of Plans	Number of Participants
1,435	10,399,000

Source: PBGC premium filings.
Note: Figures are estimates from PBGC internal calculations.

Tables 10, 11, and 12 contain information on the estimated levels of aggregate underfunding and overfunding in multiemployer plans as well as total assets and liabilities for all multiemployer plans; all multiemployer plans that are underfunded; and all multiemployer plans that are overfunded, respectively.

Table 10.−Estimated Aggregate Funding for 2011 of Multiemployer Plans

Assets	Liabilities	Aggregate Funding Ratio	Aggregate Underfunding in Underfunded Plans	Aggregate Overfunding in Overfunded Plans
$398,263,000,000	$798,963,000,000	50%	$401,080,000,000	$380,000,000

Source: Form 5500 filings.

Table 11.−Estimated Aggregate Funding for 2011 of Underfunded Multiemployer Plans

Assets	Liabilities	Aggregate Funding Ratio	Aggregate Underfunding in Underfunded Plans
$395,062,000,000	$796,142,000,000	50%	$401,080,000,000

Source: Form 5500 filings.

Table 12.−Estimated Aggregate Funding for 2011 of Overfunded Multiemployer Plans

Assets	Liabilities	Aggregate Funding Ratio	Aggregate Overfunding in Overfunded Plans
$3,202,000,000	$2,821,000,000	113%	$380,000,000

Source: Form 5500 filings
Note: Table M-13 of PBGC Pension Insurance Data Tables 2010 shows 36 multiemployer plans were overfunded for 2009 (2.4 percent of all plans for 2009), covering 0.4 percent of all participants and having 0.1 percent of total plan liabilities.

Table 13 displays data on the distribution of underfunded amounts across employers. The table shows that the ten plans with the highest levels of underfunding together account for 27.1 percent of aggregate levels of underfunding. The next 40 plans with highest underfunding account for another 27.0 percent of aggregate levels of underfunding. In 2011, 1,443 multiemployer plans were underfunded. Of these, the 50 plans with the highest levels of underfunding accounted for 54.1 percent of the total underfunding.

Table 13.−Estimated Concentration of 2011 Underfunding in Multiemployer

Plans	Underfunding Amount	Percentage of Total Underfunding
All plans	$401,080,000,000	100%
10 plans with highest underfunding	$108,541,000,000	27.1%
Next 40 plans with highest underfunding	$108,402,000,000	27.0%
All other plans	$184,137,000,000	45.9%

Source: Form 5500 filings.

Table 14 presents data on the financial condition of the PBGC's multiemployer program. As of September 30, 2013, total liabilities exceeded total assets by approximately $8.3 billion.

Table 14.−PBGC Financial Condition as of September 30, 2013, Multiemployer Plan Program[1]

Item	Amount
Total Assets	$1,719,000,000
Total Liabilities	$9,977,000,000[2]
Net position	($8,258,000,000)

[1] PBGC 2013 Annual Report.
[2] Total liabilities under the multiemployer program include the present value of nonrecoverable future financial assistance to be provided to multiemployer plans by PBGC.