

July 1, 2010

Plan Sponsors Have Opportunity for Relief from Pension Funding and Benefit Restrictions

The Preservation of Access to Care for Medicare Beneficiaries and Pension Relief Act of 2010¹ (the “Act”) provides sponsors of defined benefit plans with an opportunity for temporary funding relief. The Act allows plan sponsors to elect additional time to amortize any funding shortfalls under such plans. As discussed below, the ability of plan sponsors to take full advantage of the funding relief will likely be limited if they pay compensation to any employee in excess of \$1,000,000, pay extraordinary dividends or an extraordinary stock buy back occurs. In addition, the Act provides relief through 2010 from certain benefit restrictions under The Pension Protection Act of 2006² (the “PPA”) that apply to defined benefit plans with an adjusted funding target attainment percentage (“AFTAP”)³ below 60%.

The funding relief provisions are intended to be a temporary measure to assist plan sponsors in improving a plan’s funded status under the PPA. These provisions are not intended to replace or waive a plan sponsor’s obligation to fully fund the plan in accordance with the PPA and other applicable laws. The relief provided by the Act from the PPA benefit restrictions is available regardless of whether the plan sponsor elects the funding relief available under the Act.

In this client publication, we summarize the provisions of the Act that a plan sponsor should consider in deciding whether to elect funding relief and the provisions that apply to relief from the benefit restrictions.

¹ H.R. 3962 (enacted June 25, 2010).

² PL 109-280.

³ A plan’s AFTAP is its funding target attainment percentage (“ETAP”), as defined under Section 430(d)(2) of the Internal Revenue Code of 1986, adjusted to take into account the aggregate amount of purchased annuities for employees, other than highly compensated employees, during the preceding two plan years.

Pension Funding Relief

A plan sponsor's election to take advantage of pension funding relief under the Act is not subject to the approval of any government agency. This relief is, however, subject to the limitations and conditions discussed below.

- Electing Funding Relief. Funding relief is available for active as well as frozen plans. A plan sponsor may elect funding relief for up to two plan years during the 2008-2011 period. The Act does not require that plan sponsors elect the funding relief for consecutive plan years; however, if a plan sponsor elects funding relief for two plan years, the same amortization schedule (as discussed below) must be used for both years. Although the form and manner of the election has not yet been prescribed by the Secretary of the Treasury, plan sponsors must notify plan participants and the Pension Benefit Guaranty Corporation of the election.
- Amortization Schedule. The Act provides plan sponsors with the opportunity to extend a plan's amortization period by electing one of two amortization schedules. Generally, a plan sponsor may elect to extend the plan's amortization period to nine years (a "2 plus 7 amortization schedule") or for 15 years. A 2 plus 7 amortization schedule would require the plan sponsor to make interest only payments for the first two years of the amortization period. Thereafter, the plan sponsor would amortize the balance of the shortfall amortization base in level installments over the remaining seven plan years (i.e., if an election is made for the 2010 plan year, the shortfall amortization base would begin to amortize in 2012). A 15-year amortization schedule would require the plan sponsor to amortize the shortfall amortization base in level installments over the 15 plan years following the election.
- Increase in Required Installments. The Act requires plan sponsors to increase the amount of the installments required by the amortization schedule (the "additional contributions") under certain circumstances. For a period of three years (for the 2 plus 7 amortization schedule) or five years (for the 15-year amortization schedule), additional contributions would be required if the plan sponsor makes a payment in respect of excess compensation, an extraordinary dividend or an extraordinary stock buy back (in each case, determined on a controlled group basis). Generally, the additional contributions would be equal to the sum of:
 - compensation over \$1,000,000 paid to any employee (including any assets set aside, reserved or transferred to a trust for purposes of paying deferred compensation on behalf of the employee)⁴, and
 - the excess of any extraordinary dividends and extraordinary stock buy backs over the greater of (x) the plan sponsor's EBITDA for the plan year in which the dividend or stock buy back occurs and (y) if the plan sponsor determined and declared dividends in the same manner over the previous five plan years, the aggregate amount of the dividends paid based on such practices.⁵

⁴ The following compensation would not be taken into account under the Act, (i) compensation attributable to services provided by the employee for the plan sponsor on or before February 28, 2010, (ii) commissions, (iii) restricted stock granted after February 28, 2010 that has at least a five year vesting period and (iii) nonqualified deferred compensation, restricted stock, stock options or stock appreciation rights payable or granted under a written binding contract that was in effect on March 1, 2010 and is not materially modified.

⁵ Only dividends declared and stock buy backs occurring after February 28, 2010 will be taken into account.

The additional contributions, together with the installments due under the amortization schedule, will not be greater than the amount of the installment that would have been due had the plan sponsor not elected funding relief.

Benefit Restriction Relief

Pursuant to the PPA, a defined benefit plan with an AFTAP below 60 percent generally must cease benefit accruals for all plan participants. The Worker, Retiree and Employment Recovery Act of 2008⁶ (“**WRERA**”) provided these plans with temporary relief from the benefit accrual restriction for plan years beginning on or after October 1, 2008 and before September 30, 2009. The Act temporarily extends the relief provided under WRERA for plan years beginning on or after October 1, 2008 and before October 1, 2010 and provides that a plan’s AFTAP would be based on the greater of the funded status of the plan for the current plan year or the funded status of the plan for the plan year beginning on or after October 1, 2007 and before October 1, 2008. This relief is available regardless of whether a plan sponsor elects the funding relief described above.

In addition, the same relief is available for the PPA restrictions that would prohibit a defined benefit plan with an AFTAP below 60 percent from paying out benefits pursuant to a Social Security Level Income Option offered under the plan. This relief does not, however, extend to lump sum payments from defined benefit plans, which remain subject to the PPA restrictions.

Next Steps

The targeted funding relief provided by the Act could have substantial benefits for defined benefit pension plans, especially plans that suffered significant losses in asset value due to the market turmoil in 2008. To take full advantage of the benefits of funding relief, plan sponsors will need to act quickly as any additional contributions that may be required for 2009 must be made by September 15, 2010. As discussed above, the ability of plan sponsors to take full advantage of this funding relief will likely be limited if they pay compensation to any employee in excess of \$1,000,000, pay extraordinary dividends or an extraordinary stock buy back occurs. A decision to elect funding relief involves a review of financial as well as legal considerations and plan sponsors will need to consult with the plan’s actuaries and other advisers to determine whether funding relief should be elected.

⁶ PL 110-148

This publication is intended only as a general discussion of these issues. It should not be regarded as legal advice. We would be pleased to provide additional details or advice about specific situations if desired.

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