

The Case of the Negative Accrual?

Client's Problem:

12/31/2000: deferred vested benefit was
\$1,715/18 per month, single life annuity

4/1/2011: actual retirement amount was
\$1,544.01, single life annuity

He believed this was due to a change of
definition of Final Average Earnings (FAE)
in the Plan in 2002

Client's Relevant Documents:

- 12/31/2000 deferred vested benefit letter
- 4/1/2011 pension calculation
- Documentation showing he was grandfathered into the 'old' plan
- SPD excerpts
- 11/9/2010 letter of explanation from the company

Facts:

- In 12/2000, the pension plan was frozen for all except grandfathered (age & service points) employees who had chosen to remain in the plan. If an employee chose to opt out, they would get a larger contribution to the savings plan.
- Client opted to stay in the pension plan
- In 2002, effective 1/1/2003, the plan changed the definition of Final Average Earnings, a key part of the benefit calculation:
 - old: Average of the highest 5 consecutive calendar years of career compensation with the company
 - new: Average of the highest 5 consecutive calendar years out of the last 10 years before retirement

Facts, cont.

- The plan was frozen for all employees on 12/31/2009
- Client's highest five consecutive earning years were before 2001

Issue 1:

The Company's Rationale: Reg. 1.411(a)-7(c)(6)

The explanation the plan provided to client:

"We have reviewed the early retirement benefit you were entitled to as of December 31 for each year from 2000 through 2008 and compared this to the December 31, 2009 frozen accrued benefit of \$1,544.01 shown on your accrued benefit statement. The result of the comparison is that the frozen accrued benefit shown on the statement is correct and reflects the frozen accrued benefit that you are entitled to as of December 21, 2009, payable at normal retirement date."

**Is Reg. 1.411(a)-7(c)(6)
Appropriately used in this case?**

- No, This regulation only applies to situations where there is an early retirement benefit that is larger.
- The 12/31/2000 benefit was a NRA deferred vested benefit, not an early retirement benefit; client was not offered an early retirement benefit at that time.

**Reg. 1.411(a)-7(c)(6) Example
of Appropriate Use**

- Reg. 1.411(a)-7(c)(6) Example 1:
"Plan A provides for a benefit equal to 1% of high 5 years compensation for each year of service and a normal retirement age of 65. The plan also provides for a full unreduced accrued benefit without any actuarial reduction for any employee at age 55 with 30 years of service. Even though the actuarial value of the early retirement benefit could exceed the value of the benefit at the normal retirement age, the normal retirement benefit would not include the greater value of the early retirement benefit because actuarial subsidies are ignored."

**Issue 2:
Does the New Final Average
Earnings Definition Apply?**

- The plan cannot make an amendment that will reduce accrued benefits. To do so would be an anti-cutback violation, IRC Section 411(d)(6) and ERISA Section 204(g).
- Client cannot receive a benefit lower than the accrued benefit immediately prior to the amendment that changed the FAE.
- Requested a copy of the plan amendment and a copy of any notice of this change.

Issue 3:

A Variable Calculation Does Not Necessarily Violate the Anti-cutback Rule

Can a step-rate excess plan wear away a participant's benefit due to stagnant or reduced wages that cause a greater portion of the participant's wages to fall below the plan's definition of covered compensation, thereby designating a larger portion of the participant's benefit calculated under a less generous formula?

- The plan is permitted to have a formula that relies on fluctuating variables.
- The reduced wages combined with the increasing social security wage base pushed the benefit lower.

The Benefit Formula

Lesser of Final Average Earnings or
Covered Compensation x 0.00775
Plus
Excess of Final Average Earnings over
Covered Compensation x 0.01425
x Years of Credited Service / 12 = Monthly
Benefit

The Variables:

-Final Average Earnings

-Covered Compensation = the average Social Security wage base (the level of annual pay subject to Social Security Taxes) for the 35 years ending in the year you leave the company. This number is published annually by SSA.

2000 covered compensation was \$35,100

2011 covered compensation was \$56,628

Conclusion

The year 2000 benefit is the highest benefit because of the increasing Social Security wage base which is built into the formula and negates the last 10 years of accruals.

He is only allowed to get the higher benefit because of the plan amendment.

Client may have been better off freezing this benefit in 2000 and taking a larger contribution into the DC plan, but he could not predict that his future wages would be lower.

Benefit calculation worksheet

date	vesting service	credited service	average high 5 earnings	covered compensation
12/31/2009	38.7380 years	37.4880 years	62,979.36	56,628.00
12/31/2000	28.48734 years	28.48734 years	66,800.30	35,100.00

earnings history	
year	earnings
1996	59279.75
1997	81304.92
1998	65371.55
1999	65710.91
2000	62334.38
2001	48673.28
2002	55538.44
2003	51963.44
2004	60180.44
2005	62696.84
2006	58545.72
2007	52772.44
2008	60631.19
2009	69775.2

formula
monthly single life annuity at normal retirement age = (((.00775*lesser of average earnings or covered compensation) + (.01425*(excess of high 5 minus covered compensation))* credited service up to 35 years)/12

Benefit calculation		
benefit calculation under plan's method using 2009 definition of final average earnings, 2009 covered compensation and 2009 credited service	benefit calculation using old definition of average high 5 earnings with 2009 covered compensation amount and 2009 credited service	benefit calculation using old definition of final average earnings, 2000 covered compensation and 2000 credited service
1544.00715	1702.814969	1718.152842