# SECTION 411

# Vesting rules
# Cash balance plans

# 411 SUMMARY

| | |
|---|---|
| 411(a) | DB plans - vesting rules |
| 411(b) | DB plans - benefit accrual rules |
| 411(b)(5) | Rules relating to Age |
| 411(c) | Employee provided benefit from employee contributions |
| 411(d)(6) | Protected benefits |
| 204(h) | Notice - decrease in benefit accruals, early retirement benefits or retirement type subsidies |

# §411(a)(2)(A) DB PLANS
# MINIMUM VESTING REQUIREMENTS

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**Employee provided benefits:**
**Always 100% vested**

**Employer provided benefits:**

**(i) 100% vested after 5 years**
**(ii) 20% vested after 3 years, increase 20% per year to 100% vested after 7 years**

# MINIMUM VESTING REQUIREMENTS

**Employer provided benefits:**

**(i) 100% vested after 3 years**

**(ii) 20% vested after 2 years, increase 20% per year to 100% vested after 6 years**

**ANCIENT HISTORY**

**Can use pre-PPA vesting rules for pre-2007 plan year contributions**

## §411(a)(3) PERMITTED FORFEITURES

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A. Death (excluding QPSA)
B. Suspension of benefits upon re-employment of retiree
C. Retroactive plan amendments
D. Withdrawal of mandatory employee contributions
    i. Less than 50% vested
    ii. Must restore forfeiture on repayment with interest
E. Multiemployer – cease contributions
F. Multiemployer – reduce / suspend benefit
G. Matching contribution attributed to excess contribution (or deferral)

**Calendar year, plan year, or any other 12 consecutive month period (designated by plan) where participant completes 1,000 hours of service**

# VESTING SCHEDULE EXAMPLE

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I. Year of vesting service earned for each employment year with more than 1,000 hours

| Years of Service | Nonforfeitable Percentage |
|---|---|
| 4 | 33.3% |
| 5 | 66.7% |
| 6 | 100.0% |

II. A participant is 100% vested only if he completes 4 full calendar years of service

III. Plan Year: January 1 through December 31
Vesting Year Determination: One year of vesting service if a participant works at least 1,000 hours during each year 07/01-06/30

| Years of Service | Nonforfeitable Percentage |
|---|---|
| 3 | 10% |
| 4 | 10% |
| 5 | 100% |

# §411(a)(4) YEARS OF SERVICE - EXCLUSIONS

**In general, all years of service with the employer are included**

**Allowable exclusions:**

A. **Years before age 18**
B. **Any year employee declined to make mandatory contributions**
C. **Years before plan was established, or when employer did not maintain a predecessor plan**
D. **Years excluded due to break in service rule (see page 12)**
E. **Years before 1971 (only if employee has less than 3 years service after 1970)**
F. **Years before ERISA became effective, if they would have been disregarded under break in service rules pre-ERISA**
G. **Multiemployer plans: years after complete (or partial) withdrawal or termination**

## §411(a)(4)(C) PREDECESSOR PLAN

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**Definition from 1.411(a) regulation, which is NOT on the EA-2B reading list:**

**(1) If an employer establishes a retirement plan within the 5-year period immediately *preceding or following* the date another such plan terminates, <u>and</u>**

**(2) The other plan is terminated during a plan year to which this section applies, the terminated plan is a predecessor plan with respect to such other plan.**

# VESTING SERVICE EXAMPLE

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**Plan year:** **July 1 to June 30**

**Vesting service:**
**One year for each calendar year in which an employee earns at least 1,000 hours of service**

| 12 months ending | Hours |
|---|---|
| December 31, 2001 | 1,000 |
| December 31, 2002 | 1,000 |
| December 31, 2003 | 1,000 |
| December 31, 2004 | 900 |
| December 31, 2005 | 900 |
| December 31, 2006 | 1,000 |
| December 31, 2007 | 900 |

**Participant Smith birth date: 01/01/85**

**What is the minimum vesting service for Smith at June 30, 2007?**

## §411(a)(6) BREAKS IN SERVICE

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**A. 1-year break in service (1YBiS)**
**Calendar year, plan year, or other 12-consecutive month period (designated by plan) where participant completes less than 501 hours of service**

**B. Return to service**
**Under 411(a)(4), service prior to 1YBiS does not have to be taken into account until participant completes a year of service**

**C. DC plans / 412(e) plans**
**Service after 5 consecutive 1YBiS can be ignored for vesting of benefit prior to 5 consecutive 1YBiS**

D. Nonvested participants
   Under 411(a)(4), can ignore service prior to any period of consecutive 1YBiS if number of consecutive 1YBiS equals or exceeds <u>greater of</u>
   a. Five years, or
   b. Number of years before that period

E. Maternity / Paternity absence
   a. Up to 501 hours of service will be credited during the absence
   b. Such service is only used to determine if 1YBiS occurs
   c. Service is credited to the year the absence begins, or the following year

# §411(a)(8) NORMAL RETIREMENT AGE

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**Earlier of**

- **A. Normal retirement age defined under plan**
- **B. Later of**
  - **a. Attainment of age 65, or**
  - **b. 5th anniversary of participation**

# §411(a)(10) CHANGES IN VESTING SCHEDULE

- Can not decrease a participant's vesting percentage
- Must allow participants with at least 3 years of service to elect use of prior vesting schedule

# §411(a)(11) CASH-OUT RESTRICTIONS

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**If present value of nonforfeitable benefit exceeds 5,000, plan can not cash out this amount without consent of participant**

**Calculate present value under 417(e)(3)**

## §411(a)(13) PPA 06

## APPLICABLE DEFINED BENEFIT PLAN (CASH BALANCE PLAN)

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**Definition:**
**Accrued benefits calculated as hypothetical account balance or accumulated % of final average compensation**

**To meet vesting requirements, must have 100% vesting after 3 years**

# §411(b)(1) DB PLAN ACCRUAL RULES

**Purpose of rules is to prevent "back-loaded" benefit formulas. HCEs tend to have more years of service at plan inception, and to not terminate before retirement.**

**Front-loaded formula has higher accruals in early years of service:**

| PLAN | 1st X yr | Next Y yr | Next Z yr |
|---|---|---|---|
| A | $30 | $20 | $10 |

**Back-loaded formula has higher accruals in later years of service:**

| PLAN | 1st X yr | Next Y yr | Next Z yr |
|---|---|---|---|
| A | $10 | $20 | $30 |

# §411(b)(1) DB PLAN ACCRUAL RULES

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**NOTE: A and B are easy to check. C only works if accrued benefit is defined that way.**

**(A) 3% RULE:**

**AB ñ 3%(partic. service)(Projected Ben)**
**Projected Ben calculated assuming earliest entry age, level FAE10, retire at NRA or 65**

**(B) 133 1/3% RULE:**

**Benefit accrual rate in a year must be ™4/3 of any earlier year's benefit accrual rate**

**(C) FRACTIONAL RULE:**

**AB ñ (past partic. svc)(Projected Ben)**
**(total partic. svc)**
**Projected Ben is calculated using current FAE under the plan**

# §411(b)(1) DB PLAN ACCRUAL RULES FRACTIONAL RULE EXAMPLE

- Back loaded formulas will fail the fractional rule test, unless plan defines accrued benefit based on the fractional rule
- Don't waste time trying to figure out where the plan fails!
- Front loaded formulas <u>can</u> pass the test

**Plan formula:** $10 for 1st 10 years, $20 for 2nd 10 years, and $30 thereafter

**Entry age 21** 44 years at age 65
**Projected benefit** 1,020 / mo

| Age | Svc | Accrued Benefit | Fractional Rule | Pass? |
|---|---|---|---|---|
| 22 | 1 | 10.00 | 23.18 = 1020 (1 / 44) | FAIL |
| 23 | 2 | 20.00 | 46.36 = 1020 (2 / 44) | FAIL |

# §411(b)(1) DB PLAN ACCRUAL RULES
# 133 1/3% RULE EXAMPLE

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## Very quick calculation - can do it by eye

| PLAN | 1st X yr | Next Y yr | Next Z yr | Pass? |
|---|---|---|---|---|
| A | $10 | $20 | $30 | |
| B | $10 | $12 | $14 | |
| C | $12 | $14 | $10 | |

# §411(b)(1) DB PLAN ACCRUAL RULES
# 3% RULE EXAMPLE

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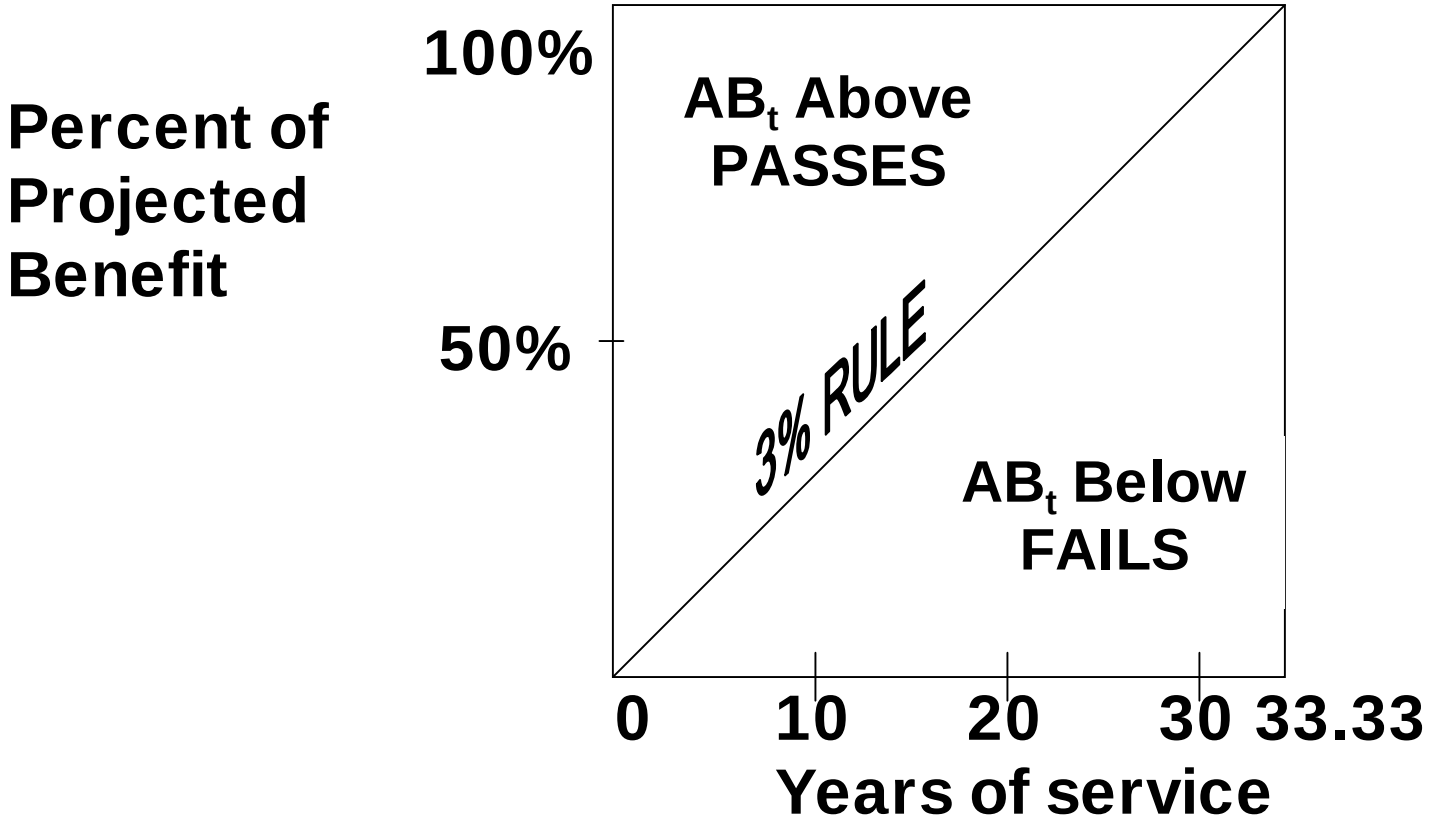
**3% rule: $AB_t \geq (.03)(t)(\text{Projected benefit})$**

- **Fractional rule based on average benefit accrual over all years of service**
- **3% rule based on average benefit accrual over the first 33 1/3 years of service**



# §411(b)(1) DB PLAN ACCRUAL RULES
# 3% RULE EXAMPLE

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**3% rule: $AB_t \geq (.03)(t)(\text{Projected benefit})$**

**If benefits accrue over more than 33 1/3 years, the plan must fail the 3% rule**

**Plan formula: $10 for 1st 10 years, $20 for 2nd 10 years, and $30 for last 10 yr**

**Entry age 21 44 years at age 65**
**Projected benefit 600 / mo**

| Age | Svc | Accrued Benefit | 3% Rule | Pass? |
|---|---|---|---|---|
| 22 | 1 | 10.00 | 18.00 = (.03)(1)600 | FAIL |
| 23 | 2 | 20.00 | 36.00 = (.03)(2)600 | FAIL |

# §411(b)(1)(G) BENEFIT CAN'T DECREASE

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**Can not decrease accrued benefit due to increase in age or service**

**Can decrease temporary benefit < Social Security benefit, which terminates when Social Security benefit starts**

# §411(b)(1)(H) POST-NRA BENEFIT ACCRUALS

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**(i) Can not decrease benefit accrual (or accrual rate) due to increase in age or service**

**(ii) Can have limit on total amount of benefits, or number of years of benefit accrual**

**(iii) Delayed retirement (see next page)**
- **(I) Distributions have commenced**
- **(II) Distributions not yet commenced**

## POST-NRA BENEFIT ACCRUALS
## 1.411(b)-2 PROPOSED REGULATION

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**This regulation is NOT on the EA-2B reading list**

1. **Start paying the Normal Retirement benefit at NRA. Post-NRA benefit accruals are reduced (usually to zero) by the actuarial equivalent of benefits paid each year.**

**Other options - do NOT start benefits at NRA, provide suspension of benefits notice:**

2. **Continue benefit accrual service after NRA.**

3. **Give the greater of the actuarial increase after NRA, or the continued benefit accrual service after NRA. Post-NRA benefit accruals are reduced (usually to zero) by the actuarial equivalent of the actuarial increase in benefits each year.**

# REVENUE RULING 81-140

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Suspension of benefits upon reemployment is allowed under §411(a)(3)(B) if reemployment

(i) with same employer, or
(ii) with multiemployer, in same industry, trade or craft, in same geographical area as when benefits commenced

If above provision is met, then NO actuarial adjustment required when benefits resume

**Allocations to employee's account can't cease due to attainment of any age**

**Rate at which amounts are allocated to employee's account can't reduce due to attainment of any age**

**Target benefit plan exception**

**Period of service starting at date of participation, which is counted under IRC 410**

**<u>410(a)(3)</u> Definition of year of service:**

**12-consecutive month period (starting from date of hire) where participant completes 1,000 hours of service**

**If less than 1,000 hours in 12-consecutive month period starting with date of hire, can use 12-consecutive month period starting from 1st day of plan year**

## §410(a)(1) MINIMUM PARTICIPATION

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**Date employee attains**

- **(A) Age 21 and 1 year of service**
- **(B) If 100% vested after 2 years, age 21 and 2 years of service**
- **(C) If tax-exempt educational institution and 100% vested after 1 years, age 26 and 1 years of service**

**§410(a)(2) No maximum age allowed**

**§410(a)(4) Time of participation**

**Must commence participation at the earlier of**

- **(A) First day of plan year following attainment of age and service reqt**
- **(B) Six months after attainment of age and service reqt**

## SPECIAL RULES RELATING TO AGE

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**(A) Comparison to similarly situated younger ee**

**(i) In general**
**Plan won't fail 411(b)(1)(H)(i) if any participant's accrued benefit as of any date would be greater than or equal to that of any similarly situated <u>younger</u> employee who could be a participant**

**(ii) Similarly Situated**
**Participant must be identical in every respect, (including service, comp, hire date, work history, etc.) except age**

**NOTE – this applies to ALL plans, not just Cash Balance plans**

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**(A) Comparison to similarly situated younger ee**

**(iii) Ignore subsidized early retirement benefits**

**(iv) Accrued benefit can be expressed as**

1. **Annuity at NRA**
2. **Balance of a hypothetical account**
3. **Current value of accumulated % of final average compensation**

## (i) INTEREST CREDITS

**Plan deemed to satisfy 411(b)(1)(H)(i) if**

- **Rate for interest credit for any year does not exceed a market rate of return**
- **Plan allowed to specify either**
  - **reasonable minimum guaranteed rate**
  - **rate = greater of fixed or variable rate**

**If interest credit < 0, account balance must never be less than accumulated contributions credited to account**

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**(v) Applicable plan amendment (APA)**

**Amendment to DB plan that converts it to an Applicable defined benefit plan (411(a)(13))**

**If benefits under 2 or more plans are coordinated to produce same effect as APA, the sponsor is treated as having adopted APA at the date the coordination begins**

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**(ii) Special rule for plan conversions**
**Plan must satisfy following requirement for each participant at the adoption date of Applicable plan amendment (APA)**

**(iii) Rate of benefit accrual**
**Accrued benefit after the amendment ñ <u>sum of</u>**

I. **AB for pre-APA service, based on plan as in effect before APA, plus**
II. **Accrued benefit for post-APA service, based on plan as in effect after APA**

**Avoids cut-back in benefits after conversion to cash balance**

## (iv) Early retirement benefit / subsidy

- Assume participant has met the eligibility requirements for early retirement (ER) prior to effective date of APA
- Assume APA causes ee to lose ER subsidy
- Plan must credit the accumulation account with the amount of ER benefit or retirement-type subsidy for the plan year in which ee retires

## (vi) PLAN TERMINATIONS

**At termination, plan must provide that**

- **If plan rate is variable**
  **Plan must use average of interest rates under the plan in 5 years before termination**

- **If plan rate is <u>not</u> a variable interest rate:**
  **Must use interest rate and mortality table specified under the plan for determining benefits payable as annuity at NRA as of the termination date**

## APPLICABLE DEFINED BENEFIT PLANS

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(C) Plan may provide offsets against benefits under the plan, if allowed under 401(a)

(D) Plan may provide disparity in contributions or benefits under the plan, if allowed under 401(l)

(E) Plan may provide indexing of accrued benefits under the plan

- Indexing is a periodic adjustment to the accrued benefit using a recognized investment index or methodology
- Indexing can't decrease the accrued benefit below its non-indexed value (allowed to decrease a variable annuity)

## REVENUE RULING 89-60

$$\text{EE provided benefit} = \frac{\text{EECWI}(1+j)^{NRA-x}}{\ddot{a}^{(12)}_{NRA} \text{ at } j\%}$$

1. Use 120% FMR to bring EECWI up to date of determination

2. §417(e) rates
   - Pre-2008: 30 year Treasury rate
   - 2008 plan year: Yield curve rates

3. Rate j is based on §417(e) rate

4. $\ddot{a}^{(12)}_{NRA}$ is based on §417(e) rate

5. Per 411(c)(3), convert EE provided benefit to plan's normal form (if not life annuity)

## POST-PPA 2006 EXAMPLE
## 2011 exam problem 23

## Employee provided benefit calculation

**Data as of 12/31/2010**

**Smith is age 47**
**EECWI 2,084.53**

**2010 Segment rates: {3.21%, 5.19%, 5.67%}**

**Factors based on 2010 segment rates:**

| | |
|---|---|
| Annuity value at age 65 | 11.93 |
| Deferred annuity from 47 to 65 (with no pre-retirement mortality) | 4.28 |

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**POST-PPA 2006 EXAMPLE**
**2011 exam problem 23**
**Employee provided benefit calculation**

| | |
|---|---|
| EECWI at 47 | 2,084.53 |
| Deferred annuity Factor at 65 | 4.28 |
| EE provided Benefit | 487.04 |

**Key question - how do you accumulate EECWI to age 65 with segment rates?**

- Use (annuity at 65 ÷ deferred annuity factor) to accumulate EECWI to age 65, or
- Use segment rates to accumulate EECWI to age 65 (WRONG answer)

**Employee provided benefit**
**As shown on prior page**

**Final accrued benefit**
**Greater of Employee provided benefit or Plan formula accrued benefit**

**Employer provided benefit**
**Final accrued benefit minus Employee provided benefit**

**Total vested benefit**
**[Employee provided benefit] * 100% plus [Employer provided benefit] * VEST%**

# §411(d)(3) PARTIAL TERMINATION

**Upon termination, or partial termination, all accrued benefits become 100% vested, to the extent funded**

**Can not reduce or eliminate:**

- Accrued benefit
- Early retirement benefit
- Retirement type subsidy (ERF's)
- Optional form

## §1.411(d)-4 regulation

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1. Defines concept of protected benefits

2. Q-1 Examples of benefits NOT protected
   a. Death or disability benefit
   b. Ancillary life insurance
   c. Health insurance
   d. Right to make 401(k) deferral

3. Q-3 Examples which violate 411(d)(6)

4. <u>Can</u> eliminate middle of 3 QJSA options
   a. can not violate new 417(g) QOSA requirement (PPA 2006)
   b. see page 417-6

# 54.4980F regulation
# 204(h) notice requirements, and penalties for non-compliance

- Apply to "significant reduction" in benefits
- Notice required 45 days before effective date
- N/A to profit sharing / stock bonus plans
- "significant reduction" based on reasonable expectations, plus facts and circumstances
- No notice needed for participants who don't experience "significant reduction"

Reduce the 45 day notice period to 15 days:

- Small plans (less than 100 participants)
- Business transactions (acquisitions or dispositions)
- Multiemployer plans

## EGTRRA 2001 CHANGES

- Include plan changes that eliminate or significantly reduce early retirement benefits or retirement type subsidies
- Notice must give sufficient info for participants to understand, also be provided within reasonable time before effective date
- Excise tax $100 per day, per individual. If reasonable diligence, cap at 500,000 / yr
- Egregious notice failure ➔ amendment has no effect

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