

A PUBLIC POLICY PRACTICE NOTE

# Preparing a Certification of the Adjusted Funding Target Attainment Percentage (AFTAP) for a Pension Plan

*Revised December 2009*

American Academy of Actuaries  
Pension Committee



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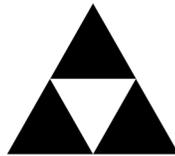
AMERICAN ACADEMY *of* ACTUARIES

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Developed by the Pension Committee  
of the American Academy of Actuaries



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PENSION COMMITTEE PRACTICE NOTE – 2009

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## **Introduction**

This practice note is not a promulgation of the Actuarial Standards Board, is not an Actuarial Standard of Practice, is not binding upon any actuary and is not a definitive statement as to what constitutes generally accepted practice in the area under discussion. Events occurring subsequent to the publication of this practice note may make the practices described in the practice note irrelevant or obsolete.

This practice note was prepared by the Pension Committee of the American Academy of Actuaries to offer information to actuaries on current and emerging practices in the preparation of the certification of a U.S. tax-qualified pension plan's adjusted funding target attainment percentage (AFTAP), as required under the benefit-restriction provisions of the Pension Protection Act of 2006 (PPA) and associated regulations.

This practice note is intended to be illustrative and spur professional discussion on this topic. Other reasonable approaches currently exist and new ones likely will evolve in the future.

This practice note also does not constitute legal advice and we encourage you to consult with qualified advisors if you have legal questions.

The committee welcomes any suggested improvements for future updates of this practice note. Suggestions may be sent to the pension policy analyst of the American Academy of Actuaries at 1850 M St. NW, Suite 300, Washington, DC 20036 or by emailing [pensionanalyst@actuary.org](mailto:pensionanalyst@actuary.org).

## I. Background

The Pension Protection Act of 2006 (PPA) introduced a number of benefit restrictions applicable to qualified pension plans that are based on the plan's funding level, including but not limited to whether or not lump sums or other accelerated benefit payments may be paid, when plan amendments can go into effect, or whether benefits may even continue to accrue. Section 436 to the Internal Revenue Code (IRC), as added by PPA, ties these restrictions to the plan's adjusted funding target attainment percentage (AFTAP) for the plan year, or to presumptions about the current year's AFTAP that are based on the AFTAP for the prior year. The plan's Enrolled Actuary (EA)<sup>1</sup> must generally certify the AFTAP to determine whether or not these benefit restrictions apply.

In October 2009, the Internal Revenue Service (IRS) issued final regulations<sup>2</sup> that provide guidance with respect to Section 436 benefit restrictions. The IRS has not prescribed a specific format for the AFTAP certification. Rather, Section 1.436-1(h)(4)(i)(A) of the regulation simply requires that the EA's certification under Section 436:

- 1) Must be made in writing;
- 2) Must be signed and dated to show the date of the signature;
- 3) Must be provided to the plan administrator; and
- 4) Except as provided in the rules regarding "range certifications," must certify the plan's AFTAP for the plan year, and must set forth the following items:
  - a. Value of plan assets;
  - b. Prefunding balance;
  - c. Funding standard carryover balance;
  - d. Value of funding target used in the determination;
  - e. Aggregate amount of annuity purchases included in the adjusted value of plan assets and the adjusted funding target;
  - f. Unpredictable contingent event benefits permitted to be paid for unpredictable contingent events that occurred during the current plan year that were taken into account for the current plan year (including any associated Section 436 contributions);

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<sup>1</sup> An Enrolled Actuary (EA) is an individual who has been approved by the Joint Board for the Enrollment of Actuaries to perform actuarial services required under the Employee Retirement Income Security Act of 1974 (ERISA). For purposes of all responses in this practice note, the EA is assumed to also be a member of one of the five U.S.-based actuarial organizations and thus subject to a uniform Code of Professional Conduct developed through a joint committee of the American Academy of Actuaries and adopted by each of the five U.S.-based actuarial organizations, the U.S. Qualification Standards promulgated by the American Academy of Actuaries, and the Actuarial Standards of Practice promulgated by the Actuarial Standards Board. To the extent Internal Revenue Service (IRS) or Department of Labor (DOL) requirements conflict with the profession's standards, the IRS and DOL requirements always govern.

<sup>2</sup> 74 F.R. 53003-53084 (October 15, 2009).

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- g. Plan amendments that took effect in the current plan year that were taken into account for the current plan year (including any associated Section 436 contributions);
- h. Benefit accruals that were restored for the plan year (including any Section 436 contributions); and
- i. Any other relevant factors.

The IRS does not require additional information to be included in an AFTAP certification; however, the certification is an actuarial communication, so our profession's standards apply. In completing the AFTAP certification, as with all actuarial consulting services, the actuary should ensure that his or her work complies with the profession's Code of Professional Conduct and applicable Actuarial Standards of Practice (ASOPs). An actuary who is requested to provide work that would not comply with the profession's standards may wish to consider discussing scope changes with the client or consider declining the engagement.

The remainder of this practice note describes the Pension Committee's view as to the possible extent of relevance of actuarial professional standards to AFTAP certifications.

## II. Questions and Answers

<p>The following provides information for actuaries when considering the two primary questions addressed by this practice note:</p> <ul style="list-style-type: none"> <li>• What documentation should I provide to the plan administrator when I deliver an AFTAP certification as required under IRC Section 436?</li> <li>• When should I deliver an AFTAP certification?</li> </ul>	
Q1.	Is an AFTAP certification a statement of actuarial opinion (SAO) subject to the Qualification Standards?
A1.	We believe the answer is yes. A plan’s funded status is measured based on actuarial calculations. SAOs are opinions expressed by an actuary in the course of performing actuarial services such as rendering advice, recommendations, findings, or opinions based upon actuarial considerations. A certification of a plan’s AFTAP would, therefore, appear to be an SAO. The EA signing an AFTAP certification should refer to the U.S. Qualification Standards at <a href="http://www.actuary.org/qualstandards/qual.pdf">http://www.actuary.org/qualstandards/qual.pdf</a> to determine if he or she is qualified.
Q2.	Is an AFTAP certification subject to ASOP No. 4, <i>Measuring Pension Obligations and Determining Pension Plan Costs or Contributions (revised September 2007)</i> ?
A2.	<p>We believe the answer is yes. An AFTAP is a pension funded-status calculation and is therefore subject to ASOP No. 4. Accordingly, an AFTAP certification would be subject to the relevant communications and disclosure requirements of ASOP No. 4, such as Section 4.1, which provides a detailed list of items (e.g., summaries of data, plan provisions and assumptions) that might be included in the communication to document the basis for the calculation. Note that this section also requires compliance with ASOP No. 41, <i>Actuarial Communications</i>, and ASOP Nos. 23, 27, 35 and 44, where applicable.</p> <p>As noted in the background section of this practice note, the IRS has prescribed the minimum content of an AFTAP certification, though it has not prescribed its form. Even if the IRS prescribes a form (such as with the Schedule SB to the IRS/DOL Form 5500), the communication requirements of ASOP No. 4 would need to be met (through attachments, the cover letter, etc.). Although ASOP No. 41, as a general matter, treats completion of a prescribed form as sufficient to satisfy that ASOP’s requirements, that approach does not override the specific communication requirements of ASOP No. 4.</p>
Q3.	What are the key communication requirements of the ASOPs as they pertain to the AFTAP certification?

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A3.	<p>Section 3.1.2 of ASOP No. 41 requires that the communication take into account the intended audience (that is, in this case, the plan administrator) and be clear and appropriate to the particular circumstances. The EA may consider whether the communication should take the form of an actuarial report, in light of the complexity and significance of the actuarial work, as well as guidance in the ASOPs.</p> <p>Due to the significance of the AFTAP certification (e.g., it determines whether benefits are restricted) and the communication requirements in other ASOPs, it is generally expected that the actuary would issue an actuarial report providing adequate documentation supporting the AFTAP certification.</p>
Q4.	<p>What constitutes an “actuarial report” for this purpose?</p>
A4.	<p>Section 3.3.3 of ASOP No. 41 indicates that an actuarial report should include not only the actuarial results of the work product, but also enough detail about the data, assumptions, and methods used so that another actuary could make an objective appraisal of the reasonableness of the actuarial work product.</p> <p>ASOP No. 4, Section 4, includes a list of more detailed components for a communication that includes, where relevant and material:</p> <ul style="list-style-type: none"> <li>• Compliance with communication requirements of ASOP Nos. 23, 27, 35, 41 and 44;</li> <li>• A statement of the intended purpose of the measurement and a statement that the measurement may not be applicable for other purposes;</li> <li>• The measurement date;</li> <li>• An outline or summary of the benefits included and excluded from the valuation;</li> <li>• The “as of” date of participant and financial data;</li> <li>• A summary of participant information;</li> <li>• A description of any hypothetical data used;</li> <li>• A description of the actuarial cost method in sufficient detail for another actuary qualified in the same practice area to assess the material characteristics of the method;</li> <li>• A description of types of benefits regarded as accrued and a description of the attribution pattern, if not described by the plan;</li> <li>• A statement appropriate for the intended audience indicating that future measurements may differ significantly from current measurement and whether the scope of work included an analysis of the potential range of future measurements;</li> <li>• A summary of changes in assumptions and methods from the prior valuation;</li> <li>• A description of any adjustments made to prior measurements in lieu of new measurements;</li> <li>• A statement if the actuary’s use of approximations or estimates could result in a significant margin for error relative to the results of a detailed calculation;</li> </ul>

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	<ul style="list-style-type: none"> <li>• The source of any prescribed assumptions or methods and, if applicable, whether the actuary is unable to evaluate them for reasonableness or if they conflict with what the actuary considers reasonable; and</li> <li>• Disclosure of any material deviation from ASOP No. 4, whether due to law or other reasons. The actuary should be prepared to justify to the actuarial profession’s disciplinary bodies any material deviations not required to comply with applicable law.</li> </ul> <p>Since the AFTAP certification is not provided on a preformatted form required by the IRS, an acknowledgement of the EA’s qualifications is also generally required (see Section 5 of the Qualification Standards).</p>
Q5.	<p>Does this mean that when I provide the AFTAP certification to the plan administrator, I have to provide it as part of a complete actuarial report?</p>
A5.	<p>We believe the answer is no. As noted in Section 3.1 of ASOP No. 41, the standard applies to the cumulative communications for each specific engagement. It allows an individual communication to be combined with other communications that are part of the assignment in order to meet the standard. Thus, the actual certification of the AFTAP could be as minimal as is needed to satisfy the IRS requirements. However, other communications would need to be used to provide the additional information necessary to satisfy the standard, and Section 3.1.3 of ASOP No. 41 requires that all the necessary pieces of the cumulative communication need to be issued within a reasonable time after completing the actuarial analysis, unless other mutually satisfactory arrangements are made. In addition, the actuary may want to consider the extent to which it would be useful to make reference to these other communications, prior and pending, that would be considered part of the cumulative communication.</p> <p>Because of the significance of the AFTAP certification (e.g., it determines whether benefits are restricted), and especially because the plan administrator may immediately rely on the communication to determine whether or not to restrict benefits, the EA would generally issue the AFTAP certification as part of a full report or would have satisfied the cumulative communication standard at the time of the issuance of the AFTAP certification. However, if delay of the full report or satisfaction of the cumulative communication standard is necessary, it may be appropriate for the plan administrator to receive the critical elements supporting the AFTAP certification by the time the administrator needs to rely upon the certification (such critical elements may include such items as the interest rate/yield curve applied, plan amendments that were not reflected, changes in assumptions since the prior certification, and elections about credit balances).</p>
Q6.	<p>May I utilize prior communications, such as the last year’s actuarial valuation report, to meet the communication requirements?</p>

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A6.	<p>We believe the answer is yes. As noted in several of the ASOPs discussed above, the actuary may refer to communications associated with prior projects to satisfy the communication requirements associated with this project. For example, Section 4.1 of ASOP No. 4 allows an actuary to reference other actuarial communications and reports available to the intended audience in meeting the communication standard.</p> <p>However, if new or different information is used since the prior year’s actuarial valuation report, such as use of participant data as of a different date or use of new actuarial assumptions, the actuary may want to consider the additional disclosure that may be needed about that new or different information.</p>
Q7.	<p>Can I add the AFTAP certification to the regular annual actuarial report I produce to document the funding results?</p>
A7.	<p>We believe the answer is yes. Pending any additional IRS direction, it does not appear that the AFTAP certification needs to be a separate actuarial report. It can be included with your regular annual actuarial report for funding purposes that includes the information required of an actuarial communication and is addressed to the appropriate audience (the plan administrator). But as noted in Question 5 above, timing is a consideration given the significance of an AFTAP certification. Also, the report for funding purposes may be intended for or accessible to a broader audience than the audience that the plan administrator wishes to receive the AFTAP certification.</p>
Q8.	<p>When should the EA prepare the AFTAP certification? Should the certification be issued immediately upon measurement of the plan’s funded status?</p>
A8.	<p>No official guidance has been issued on this question, and the EA may wish to consult with legal counsel. However, in general, it appears that the plan administrator controls the timing of the AFTAP certifications and the EA will follow the plan administrator’s instructions.</p> <p>The statute and regulations provide explicit guidance about plan operation before and after specific dates when there is, and is not, a current AFTAP certification in place. However, the law does not appear to impose a direct duty on the plan’s actuary to issue an AFTAP certification. This contrasts with the duty imposed directly on the actuary, by ERISA Sections 305(b)(3)(A) and 432(b)(3)(A), to certify by a stated deadline whether a multiemployer plan is in endangered or in critical status. And thus far, the IRS and Department of Labor (DOL) have not provided any additional guidance on the duty to issue AFTAP certifications. As such, it does not appear that the EA has an independent duty to formalize an AFTAP certification at any given point.</p> <p>Absent official guidance to the contrary, the final decision on when a valuation is complete appears to be the responsibility of the plan administrator. Once the valuation is deemed complete by the plan administrator, the EA may wish to</p>

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	<p>request that the plan administrator provide authorization to the EA to complete the certification.</p> <p>The preamble to the final regulations does acknowledge the issue of timeliness of AFTAP certifications and indicates that future proposed regulations may address this issue. Furthermore, according to the preamble, the Treasury Department, IRS and DOL will coordinate to “consider the circumstances in which the power to delay issuance of a certification may result in fiduciary responsibilities in the administration of the plan, rather than being merely ministerial.”</p> <p>For more discussion on this issue, see the Academy Pension Committee’s comment letter to the IRS at: <a href="http://www.actuary.org/pdf/pension/irs_nov07.pdf">http://www.actuary.org/pdf/pension/irs_nov07.pdf</a></p>
Q9.	<p>What could the actuary do if he or she knows, or has reason to believe, that the AFTAP certification, once issued, will trigger a benefit restriction (or end one that is already in effect) before the date that the plan administrator has instructed the actuary to issue the certification?</p>
A9.	<p>As noted above, the administration of the plan, including benefit restriction matters, is the plan administrator’s responsibility. Beyond securing the AFTAP certification from the EA, the administrator must also deal with the implementation (or elimination) of benefit restrictions. The statute and regulations provide explicit guidance about plan operation before and after specific dates when there is and is not a current AFTAP certification in place, and the administrator is the one who must ensure operation within those rules. While the EA may advise the client about the AFTAP’s expected value, the EA does not appear to be required to formally certify the AFTAP without the plan’s administrator’s direction.</p> <p>Again, since no definitive answer exists regarding any such duty, the EA may wish to discuss this matter with legal counsel.</p>
Q10.	<p>If the plan administrator directs the EA not to issue an AFTAP certification, should the EA nevertheless prepare one and, if so, when?</p>
A10.	<p>As discussed above, the plan administrator has the responsibility for plan administration, including the valuation process and the application of benefit restrictions. The EA may make the plan administrator aware of the implications of issuing or not issuing an AFTAP certification by certain dates so that the plan administrator can make an informed decision. Once this decision is made, the EA would most likely follow the instructions of the plan administrator.</p> <p>The plan administrator typically acts both as a plan fiduciary and as an agent of the employer in making decisions regarding plan benefits. In such a situation, the EA would generally defer to the plan administrator’s judgment and not get involved in issues of a fiduciary nature.</p>

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Q11.	If the plan administrator neither requests an AFTAP certification nor specifically instructs the EA not to issue one, should the EA nevertheless prepare an AFTAP certification and, if so, when?
A11.	<p>The plan administrator has the duty to properly operate the plan, and thus it seems unlikely the administrator would withhold direction from the EA. However, in the event that no direction is provided, the situation is essentially the same as those discussed in the questions above—there does not appear to be a requirement that the EA issue any certification by any date without the plan administrator’s direction.</p> <p>Again, the prudent EA may raise the issue and attempt to ensure that the plan administrator understands the timing requirements and implications of issuing or not issuing an AFTAP certification. The EA may also clarify the actions he or she will take based on instructions, or lack thereof, from the plan administrator. However, there does not appear to be a requirement that these actions include the issuance of an AFTAP certification in the absence of a specific request from the plan administrator.</p>
Q12.	When does the EA issue a range certification, and, if one is being issued, should it be on a best estimate basis, or with added margin?
A12.	<p>Like the certification of a specific AFTAP, a range certification is generally provided only in accordance with the plan administrator’s instruction.</p> <p>However, as a range certification is by nature an estimate, there may be additional issues associated with it. Specifically, the actual AFTAP could eventually turn out to be materially different (with respect to the applicability of benefit restrictions) than the range certification. This could cause a host of issues for the plan administrator, including corrections that may be available to avoid plan disqualification and unexpected contribution requirements to avoid benefit restrictions. As the potential for a materially different result would seem to increase as the best estimate gets closer to certain key thresholds (e.g., 60 percent or 80 percent), the EA may consider adding margins in determining what to certify and/or whether to issue a range certification at all (keeping in mind that a range certification that proves either materially too high or materially too low could be problematic). However, there is no requirement to do so.</p> <p>The EA may discuss with the plan administrator the proximity of the best estimate of the AFTAP to the key benefit restriction thresholds, as well as the issue of confidence levels and any added margins. These discussions may include the sources and quality of information, the ability to rely on information provided by the plan administrator and third parties, the possibility of actual results being materially different than the range certification and the implications that such an outcome would have on the plan administrator. If the plan administrator understands these issues, accepts the risks associated with them and requests a range certification from the EA that is based on the best estimate of the</p>

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<p>AFTAP, current IRS guidance does not appear to prohibit the EA from issuing such a range certification. However, the EA is not required to issue such a range certification, and would want to carefully weigh the risks of issuance, in consultation with the plan administrator.</p>
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