Questions

**Answers to Self Assessment ~~Problems~~ for Chapter 6**

1. For a defined contribution plan, the accrued benefits is the sum of all the benefits that have accumulated to date, including current year investment earnings. In contrast, the accrual refers to the annual amount allocated to the participant's account according to the allocation formula. For a defined benefit plan, the accrued benefit is expressed in three parts – a unit benefit formula, commencing as of a given NRA, with a normal form of benefits. In contrast, the accrual refers to the percentage applied to the unit benefit formula.

   The current year accrual is 5% of compensation of $50,000 = $2,500.
   The current accrued benefits = prior year's accrued benefit of $30,000 + current year's accrual of $2,500 + current year's investment gains $1,000 = $33,500

2. c. II is false. According to IRC §411(b), the "normal retirement age" that requires 100% vesting is the earlier of (1) the plan's normal retirement age or (2) the later of (i) age 65 or (ii) the 5th anniversary of participation. For example, if the plan's normal retirement age is 60, the earlier of (1) age 60 or (2) the later of (i) age 65 or (ii) the 5th anniversary of participation equals age 60; whereas if the plan's normal retirement age is 70, the earlier of (1) age 70 or (2) the later of (i) age 65 or (ii) the 5th anniversary of participation equals the later of (i) age 65 or (ii) the 5th anniversary of participation. Thus in the latter situation, a participant hired at age 62 would not be entitled to 100% until age 67.

3. This type of formula could be seen in the conversion of a traditional defined benefit plan into a cash balance plan. It is referred to as the "wear away" approach as an existing participant's benefit doesn't increase after the amendment until the first benefit in part one exceeds the benefit in part two. The First Circuit in *Campbell v. BankBoston, N.A.*, 327 F.3d 1 (1st Cir. 2003) held such wear away formula did not violate the anti-cutback rule as it affected only the *future* benefit accruals.

4. a. This NRB formula is equivalent to a formula equal to [3% × FAE × yrs (cap 25)]/65/life only or J&S. Hence the IRC §411(b) 3% Rule is satisfied as the accrual of 3% is uniform and fully accrues within 33⅓ years. The 133⅓ Rule is met since the annual accrual rate is uniform.

   b. AB = [3% × FAE × yrs (cap 25)]/65/life only or J&S = [3% × $150,000 × 10 yrs]/65/life only = $45,000/65/life only

5. To the extent the cost-of-living feature is defined under the plan as part of the pension or retirement benefit, case law affirms that it is a protected accrued benefit and therefore cannot be reduced with respect to benefits accrued to date. *See Hickey v. Chicago Trust Drivers, Helper & Warehouse Workers Union,* 980 F.2d 465 (7th Cir. 1992); *Laurenzano v. Blue Cross and Blue Shield of Massachusetts*, 134 F. Supp. 2d 189 (D. Mass. 2001); and *Shaw v. International Association of Machinists & Aerospace Workers Pension Plan*, 750 F.2d 1458 (9th Cir. 1985).

6. True

7. Formula 1: an annual accurate rate of 5% is pretty high because it takes only 20 years to attain the full NRB. However, it's easier to administer and to explain than the fractional rule.

   Formula 2: this accrual rate will result in lower accruals for the staff employee and the younger shareholder than the 5% annual rate. Since the fractional rule applied to the NRB will produce larger accruals for the two older shareholders, the funding for these accruals will be proportionate over their remaining future working lifetime. If the older shareholders believe that the staff employee is not interested in benefits or will terminate with little or no vesting, the fractional rule results in lower overall contributions for the business.

8. This was the issue addressed by the Seventh Circuit in *Jones v. UOP*. The purpose of the anti-backloading rules of ERISA §204 and IRC §411(b) was to prevent an employer from defeating the vesting rules. If benefit could accrue very slowly until the employee reached near retirement age, the employee's pension benefits, even if vested, would have very little value until he/she had completed a much longer period of service. In determining vesting, ERISA requires all the employee's years of service, before and after ERISA went into effect, to be counted. ERISA §203(b)(1)(F) provides an exception for years before ERISA's passage if such service would be disregarded under the break-in-service rule. While ERISA §204(b)(1)(D) does not contain an express reference to the break-in-service rules, the court considers the interplay between Sections 203 and 204 and reads the rules similarly. Hence, in invalidates backloaded plans even if they were adopted before ERISA took effect. Section 204 protects employees from the employer's efforts to circumvent Section 203's vesting rules, but it does not defeat the break-in-service provisions in plans adopted before ERISA's passage.