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OBSERVATIONS ON THE FUNDING STANDARD ACCOUNT

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The Funding Standard Account is the device employed by ERISA to assure compliance with the minimum funding standards of the law. In essence, it is the accumulation, with interest, of plan contributions by the plan sponsor less the minimum contributions required by the law. Credit items to the funding standard account include the previous year credit balance, if any; contributions by the plan sponsor; amortization credits, and interest on the credit items. Debit items include the previous year debit balance, if any; the normal cost; amortization charges, and interest on the debit items.

Offsetting of Amortization Charges and Credits

Combination of charges and combination of credits (discussed in the next section) are required if it is desired to offset amortization credit balances directly against amortization charge balances. The amortization period for the balance remaining after the offset will be the same as the amortization period of the larger balance before the offset. Offsetting can produce a significantly different amortization program for the smaller of the two balances. For example, if the remaining periods are 30 years for the charges and 15 years for the credits, the effect of offsetting would be to accelerate charges substantially (if the credits predominate), or to decelerate credits substantially (if the charges predominate). In either event, the funding requirements would be accelerated. If the remaining periods were 15 years for the charges and 30 years for the credits, offsetting would decelerate the funding requirements.

Combinations of Amortization Charges (Credits)

A reasonable way to perform a combination would be to do it in such a way that the total amount remaining to be amortized and the total annual amortization instalment both remain unchanged, with the remaining amortization period being determined by the formula:

$$n = \text{colog} \left[1 - \frac{i}{(1+i)\, f} \right] \div \log\,(1+i)$$

which is derived from the basic formula $f\ddot{a}_{\overline{n}|} = 1$, where f denotes the ratio of the total annual amortization instalment to the total amount remaining to be amortized, i denotes the valuation interest rate, and n denotes the weighted average remaining amortization period.

Combination of amortization charges (credits) in this way has the net effect of accelerating the charges (credits) to the funding standard account, but this acceleration effect is deferred until such time as one of the component unamortized balances is scheduled to become completely amortized. It thus appears that unless there is to be an offsetting of amortization charges and credits, there is no compelling reason for considering combination until this time arrives.

The Full Funding Limitation Credit

The Full Funding Limitation (FFL) as of the end of the plan year is the excess, if any, of

(A) the accrued liability under the plan *over*

(B) the lesser of

(1) the fair market value of the plan's assets, and

(2) the valuation basis value of the plan's assets.

If the actuarial cost method is the aggregate cost method, under which the accrued liability may be defined as equal to the plan assets, this formula does not make much sense, so for this cost method, it is suggested that the FFL be determined according to the entry age normal cost method. If there is a debit balance in the Funding Standard Account that exceeds the FFL, as of the end of the plan year, the excess amount is credited to the Funding Standard Account, and all remaining unamortized charge and credit balances are cancelled.

An important difficulty with this FFL is that it cannot be determined until the end of the plan year, and thus it cannot be relied upon to provide relief from the minimum funding requirements for that plan year. It should be noted that the FFL as of the beginning of the plan year (including the normal cost for the year) is a component in determining the maximum deductible contribution for the year since the deduction for the year may not exceed the Full Funding Limitation as of the beginning of the year. Thus, for consistency, there needs to be an interpretation of the FFL credit that is based on the FFL as of the beginning of the year.

Thus, it is reasonable to conclude that the intent of the law would be satisfied by determining a supplementary FFL credit as follows:

If there is a debit balance in the Funding Standard Account, as of the end of the plan year (after applying the FFL credit, if any, as of the plan year, as described above), tha exceeds the excess, if any, of

(A) the FFL as of the beginning of the year together with interest on such limitation to the end of the plan year, *over*

(B) the contributions by the plan sponsor during the year together with interest on such contributions to the end of the plan year,

such excess amount of debit balance in the Funding Standard Account is to be credited to the Funding Standard Account as a supplementary FFL credit, and any unamortized charge and credit balances *remaining from such balance outstanding as of the beginning of the year* are cancelled. The FFL as of the beginning of the year is the excess, if any, of

(A) the sum of

(1) the accrued liability as of the beginning of the year and

(2) the normal cost for the year, *over*

(B) the lesser of

(1) the fair market value of the plan's assets as of the beginning of the year or

(2) the valuation basis value of the plan's assets as of the beginning of the year.

The Alternative Minimum Funding Standard Account

If there still remains a debit balance in the Funding Standard Account after recognition of any FFL credit and any supplementary FFL credit, then the alternative minimum Funding Standard Account may be calculated to see whether there is a zero debit balance therein, or a debit balance that

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is less than that in the Funding Standard Account. However, there is an eligibility condition to be satisfied before the alternative minimum Funding Standard Account can be used. The eligibility condition specified in the law requires some interpretation, and the following interpretation is suggested:

A plan which uses an actuarial cost method that determines a minimum plan contribution required to avoid an accumulated funding deficiency which, in each year (beginning with the first year to which the funding standards of ERISA apply and ending with the year at the end of which the alternative minimum Funding Standard Account is to be calculated), is not less than the corresponding minimum plan contribution determined by using the entry age normal cost method, may maintain an alternative minimum Funding Standard Account for the plan year.

The determination of the balance in the alternative minimum Funding Standard Account, as specified in the law, requires some interpretation, and the following is suggested:

Credit items to the alternative minimum Funding Standard Account include the contributions by the plan sponsor and interest thereon, while the debit items include the previous year debit balance, if any, (if used to determine the accumulated funding deficiency in the previous year), the lesser of the normal cost for the year and the normal cost calculated on the unit credit method, the excess, if any, of the present value of accrued benefits over the fair market value of the plan assets, as of the beginning of the year, and interest on the debit items.

The accumulated funding deficiency is the lesser of the debit balance, if any, in the Funding Standard Account and the debit balance, if any, in the alternative minimum Funding Standard Account.

If the accumulated funding deficiency was determined at the end of the previous year by the alternative minimum Funding Standard Account, and is to be determined at the end of the current year by the Funding Standard Account, then there must be a credit made to the Funding Standard Account arising from the alternative minimum Funding Standard Account. The law's description of this credit requires interpretation and the following is suggested:

In the case of a plan year for which the accumulated funding deficiency is determined under the Funding Standard Account, if such plan year follows a plan year for which such deficiency was determined under the alternative minimum Funding Standard Account, the excess (if any) of any debit balance in the Funding Standard Account over any debit balance in the alternative minimum Funding Standard Account, as of the end of the previous year, together with interest on such excess, is to be credited to the Funding Standard Account.

It is to be noted that if such a credit is made to the Funding Standard Account, then the amount of the credit must be set up as an unamortized charge balance to be amortized over 5 years. It is believed that the amortization charge must begin in the year after the credit is made to the Funding Standard Account, and also that the amortization must remain even if there were a FFL credit and/or a supplementary FFL credit to the Funding Standard Account in the same year as the alternative account credit.

Minimum Contribution Required to Assure Avoidance of an Accumulated Funding Deficiency

Having gone through a discussion of the Funding Standard Account, we are now in position to determine the bottom line — the minimum plan contribution for the following year that will assure the avoidance of an accumulated funding deficiency.

The minimum contribution that will assure avoidance of an accumulated funding deficiency is the least of A, B, and C, where

(A) is the minimum contribution required to avoid a debit balance in the Funding Standard Account, and is the sum of

(1) the debit balance, if any, in the Funding Standard Account,

(2) the normal cost, and

(3) the amortization charges,

less the sum of

(4) the credit balance, if any, in the Funding Standard Account,

(5) the amortization credits, and

(6) the excess, if any, of any debit balance in the Funding Standard Account over any debit balance in the alternative minimum Funding Stanard Account,

(B) is the minimum contribution required to avoid a debit balance in the alternative minimum Funding Standard Account (if eligible for the use of this account), and is the sum of

(1) The debit balance, if any, in the alternative minimum Funding Standard Account (but only if the accumulated funding deficiency at the end of the previous year was determined by the alternative minimum Funding Standard Account),

(2) The lesser of

a. the normal cost and

b. the normal cost determined on the unit credit method,

and

(3) The excess, if any, of

a. the present value of accrued benefits, over

b. the fair market value of the plan's assets,

and

(C) is the FFL as of the beginning of the following year, and is the excess, if any, of the sum of

(1) The accrued liability and

(2) The normal cost,

over the lesser of

(3) The fair market value of the plan's assets and

(4) The valuation basis value of the plan's assets, together with interest on such least amount from the beginning of the year to the date or dates of payment. □