Pension Funding Relief Has Arrived

What does defined benefit pension plan funding have to do with highway construction and student loans? All three are included in the Moving Ahead for Progress in the 21st Century Act (MAP-21 for short). In fact, the pension provisions are paying for highway construction and reduced interest on student loans. Contributions for pension plans are tax-deductible and the recent increases in required contributions to defined benefit (DB) plans are reducing tax revenue.

Beginning with the 2008 plan year, pension funding rules under the Pension Protection Act (PPA) changed dramatically. Perhaps the most impactful change was mandating interest rates to determine pension liabilities. PPA requires the use of the corporate bond yield curve to value DB plan benefits. The only smoothing option for interest rates is the use of a 24-month average of a three-segmented yield curve. Right after the new rules came into effect, the economic downturn began. Not only did asset values drop significantly, so did interest rates. The Federal Reserve has adopted policies to keep interest rates low through 2014. The combined loss in asset values and dramatic reduction in interest rates increase DB plan contribution requirements significantly. These higher deductible contributions result in reduced tax revenue. Many sponsors of DB plans have felt the economic pinch of these high contribution requirements. Both the government and DB sponsors have a mutual interest in reducing these contributions.

The pension funding stabilization provisions of MAP-21 place a corridor around the segmented interest rates used to determine the minimum required contributions for DB plans .Beginning with the 2012 plan year, the 24-month average segment rates cannot be more or less than a percentage of the 25-year average of the segment rates. The corridor expands over time as follows:

Calendar Year	Applicable Minimum Percentage	Applicable Maximum Percentage
2012	90%	110%
2013	85%	115%
2014	80%	120%
2015	75%	125%
After 2015	70%	130%

The biggest impact of the interest rate change will be in these first few years. This is not only due to the narrower corridor but to the current low interest rate environment. The approach of putting a corridor around the required interest rates recognizes that economic conditions in certain periods of time are highly unusual and not representative of the long term nature of DB plan benefits. This is a positive step in pension funding.

MAP-21 does not change the interest rates for determining the maximum deductible contributions for DB plans. It increases contribution flexibility for all DB plan sponsors by allowing DB plan sponsors who are in a position to, and want to, to make fully deductible large cash contributions to their plans.

Main 503.520.0848
Toll Free 888.643.5179
Fax 503.520.1147
15725 SW Greystone Court, Suite102
Beaverton, OR 97006-6016
www.independentactuaries.com

The interest corridor will be determined and published by the Internal Revenue Service. As noted above, the current segment rate structure was first required for the 2008 plan year so there is not a 25-year history of these rates at this time. MAP-21 authorizes the Service to determine equivalent rates for years in which the segment rates are not available. Now we must wait for the Service to publish the corridor. The general consensus is that the application of the corridor will result in a 100 to 150 basis point increase in the interest rates. If this is true, liabilities will drop between 10% and 20% resulting in significantly lower minimum required contributions (MRCs). We do not know if the corridor rates will be published in time to accurately determine the 2012 plan year quarterly contribution due on July 15, 2012 for many plan sponsors. (Only certain plans are required to make quarterly contributions).

Not all the pension provisions in MAP-21 are positive for DB plan sponsors. For those plans that are covered by the Pension Benefit Guaranty Corporation (PBGC), annual premiums are going to increase. PBGC premiums consist of two parts – a flat rate premium per participant and a variable premium based on the unfunded liability in a DB plan. For 2012, the flat rate premium is $35. This will increase to $42 for 2013, $49 for 2014 and increase with inflation thereafter. The variable premium rate is currently $9 for each $1,000 of unfunded vested liability. The $9.00 will be adjusted for inflation and increased by $4 in 2014 and an additional $5 in 2015. Rates are expected to be at least $14 per $1,000 in unfunded vested liability in 2014 and $19 per $1,000 in unfunded vested liability in 2015 (more than double the 2012 rate). For plans of employers with more than 25 employees the variable premium will be capped to $400 per participant in 2013 and the $400 will be adjusted by inflation thereafter.

For PBGC-covered plans with 50 or more participants, if the plan's funded status is less than 95% using segment rates before application of the corridor and the asset value is more than $500,000 less than liability, additional disclosures will be added to the Annual Funding Notice (AFN) distributed to participants. The AFN is the multipage notice required by PPA. The notice includes the disclosure of a plan's funded percentage. These plans will have to disclose the plan's funded status before the application of the interest rate corridor and what the MRC would have been without the interest rate corridor.

There are other provisions related to benefit restrictions and plan sponsor elections that only apply to certain affected plans. For more information, please contact Independent Actuaries, Inc.

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This article was written by Elizabeth A. Moore, FSA, EA, MAAA. Libby is Vice President and an owner of Independent Actuaries, Inc. Her specialty areas include large plan actuarial valuation services, defined benefit pension plan accounting under the Accounting Standard Codification, and hybrid plans. She has 17 years of experience including national actuarial firm experience.