PENSION TRENDS
BY INDEPENDENT ACTUARIES, INC.

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The Perfect Storm—A Decade Later

Back in 2006, the Pension Protection Act (PPA) became law but it didn't impact defined benefit plan funding requirements until 2008. PPA embraced financial economics. Projected distributions from defined benefit plans were treated like a series of bond payments and were discounted using a corporate bond yield curve. The resulting liability was no longer tied to an interest rate based on the investment policy of the plan. The rates were mandated by the IRS and were close to "current" market rates. As a result, liabilities were measured using a lower interest rate and were generally much higher than if calculated under the prior method. We had a couple of years to prepare ourselves and our clients for the impact of the new law. What we weren't prepared for was the economic downturn in the fall of 2008. Every actuarial publication and every actuarial meeting mentioned the "perfect storm" of the new law and the economic downturn.

The effect of the economic downturn on defined benefit plans was exacerbated by the PPA changes to the funding calculations. The asset and interest rate smoothing methods available under PPA didn't allow for much relief from high contribution requirements. As we put together estimates for funding requirements for the 2009 plan year, we could tell that our clients would not have enough time to prepare for the large spike in contributions.

It's worth noting at this point that, for the majority of our clients, getting a tax deduction from large contributions is a major incentive to sponsor a defined benefit plan. As a result, most of these plans were well-funded and weathered the storm without difficulty. Other sponsors, however, were less well positioned.

Actuaries began looking for any options available to help those clients make it through this funding crisis. Regulations for many aspects of PPA had not been completed. There was some ambiguity in the language around the mandated interest rates and a crazy spike in the yield curve rates for October 2008. By using the full yield curve published for October 2008 (which was an option for plan sponsors), the interest rate would be higher, resulting in a lower liability and inequity among sponsors.

Under the backdrop of this turmoil, major employee benefits and actuarial organizations began lobbying the IRS and lawmakers for pension relief. So after just one year, we received the first pension relief for PPA. The IRS allowed the use of the full yield curve with a three-month lookback. They gave automatic approval for a change in asset method and released Notice 2009-22 detailing the asset smoothing method. Minimum contribution requirements increased, but the amounts would have been a lot higher if not for the relief.

These were the first pension relief provisions after PPA but were not the last.

With the lingering recession came another pension relief option in the next year. The Pension Relief Act of 2010 (PRA 2010) provided an extension of the shortfall amortization. Under PPA, the shortfall is amortized over seven years. PRA 2010 allowed plan sponsors to elect to lengthen the amortization period by either extending it from seven to 15 years, or using interest-only payments for two years and full amortization payments for the next seven years. Not all plan sponsors elected this relief. There were conditions for use of the relief including participant notification and limits on compensation, dividends and stock redemptions that, if exceeded, would result in additional contributions.

It is important to note that the government didn't provide pension relief just to help out plan sponsors weather the recession. Pension contributions are tax deductible, so higher contributions means less revenue for the government. PRA 2010 was part of a larger piece of legislation – the Preservation of Access to Care for Medicare Beneficiaries and Pension Relief Act of 2010. The lower contribution requirements reduced tax deductions and raised revenue to fund Medicare. So, when it was time to look for ways to fund an infrastructure bill, pension relief was once again an excellent option.

The Moving Ahead for Progress in the 21st Century Act (MAP-21) was signed into law in 2012. MAP-21 added smoothing back into the interest rate calculation. The segment rates used to determine the minimum funding requirements under PPA were averaged over 24 months. MAP-21 added a corridor around those rates. The rates could not be less than 90% of the 25-year average of the 24-month average segment rates nor greater than 110%. The 110% side of the corridor was not going to impact anything, but the 90% side raised the mandated interest rates significantly. The interest rate corridor was set to expand by an additional 5% each year and settling at 70% to 130% for 2016 and after. The relief came with a big downside – increased PBGC premiums.

In 2014, there was another infrastructure bill and with it more pension funding relief. The Highway and Transportation Funding Act of 2014 (HATFA) preserved the 90% to 110% corridor established by MAP-21 through 2017. The corridor would begin expanding with the 2018 plan year. The relief was retroactive to the 2013 plan year as well. So, highways were funded and plan sponsors had relief, this time without increasing PBGC premiums.

The next time Congress needed to find revenue, it wasn't just for infrastructure. The government was facing default due to the debt ceiling limit. The Bipartisan Budget Act of 2015 (BBA-15) extended the 90% to 110% corridor for an additional two years to 2019. The 90% end of the corridor has been controlling the rates ever since. The BBA-15 also increased PBGC premiums again.

As you can see, the last decade has been a wild ride for pension funding rules. Raising tax revenue is intricately connected with pension funding requirements. And if the economy experiences another downturn or the government needs more revenue, there will be new relief provisions and the ride will continue.

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Author Profile:

This article was written by Libby Moore, FSA, EA, MAAA. Libby is an IAI owner and consultant. She specializes in large plan actuarial valuations, defined benefit plan accounting under the Accounting Standard Codification and under applicable GASB statements for public sector plans, and cash balance plans.

INDEPENDENT ACTUARIES, INC.

4500 Kruse Way, Suite 200
Lake Oswego, OR 97035
Phone: 503.520.0848
Fax: 503.520.1147
IndependentActuaries.com

email:
info@indact.com