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Recently Enacted Highway Bill Includes Pension Plan Funding Stabilization, PBGC Premium Increases and Other Pension-Related Provisions

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On July 6, 2012, President Obama signed into law the Moving Ahead for Progress in the 21st Century Act ("MAP-21"), a transportation bill that contained revenue-generating pension provisions that are particularly relevant for sponsors of defined benefit pension plans. Specifically, the pension provisions contain (i) relief from the pension funding requirements attendant to the current low interest rate environment; (ii) Pension Benefit Guaranty Corporation ("PBGC") premium increases for single employer and multiemployer plans; (iii) certain improvements to PBGC governance; and (iv) new rules allowing the transfer of excess pension assets.

Pension Funding Relief

Background

Prior to the Pension Protection Act of 2006, the annual minimum funding contribution required to be made by the plan sponsor of a defined benefit pension plan was determined based, in part, on an assumed rate of return determined with reference to the expected return on the plan's assets. However, the PPA redesigned these pension funding rules to shorten the period over which a funding shortfall had to be amortized and to require plans to determine minimum funding obligations with reference to corporate bond yields.

Specifically, under the PPA, for the purposes of determining its minimum funding obligations, a single employer plan may calculate the present value of benefits using either the yield curve or three segment rates. The yield curve is the yield on corporate investment-grade bonds as reported by the Treasury Department. Use of the three segment rates is intended to provide a more stable interest rate, by allowing a plan to use an average of the last 24 monthly yield curves (using a lookback of up to four months prior to the beginning of the plan year).

In light of the recent recession, the Federal Reserve has attempted to support and stimulate the economy by reducing interest rates and maintaining them at historically low levels. Unfortunately, the net impact is that employers have seen their minimum contribution requirements accelerate substantially, requiring significant up-front cash outlays.

Relief

Under MAP-21, the three segment rates are now "collared" with an upper and lower limit based on historic interest rates. Specifically, if the segment rate calculated using the normal 24-month average is not within a designated percentage of the historic average over the last 25 years (calculated as of September 30 of the calendar year preceding the calendar year in which the plan year begins), then the segment rate is limited to that percentage. The percentage is 10% for plan years beginning in 2012 and increases by 5% in each subsequent plan year until it hits 30% in 2016. So, for example, for plan years beginning in 2013, the minimum segment rate is 85% and the maximum is 115% of the average for the 25 years ending September 30, 2012.

For the 2012 through 2014 plan years, plans with at least 50 participants on any day in the preceding plan year with a funding shortfall of at least $500,000 and a stabilized funding target that is less than 95% of the non-stabilized funding target must include in their annual funding notices certain information regarding the effect of stabilization on plan funding. This information includes, a statement of the modified method, a statement that the plan sponsor may contribute less money when interest rates are at historic lows, and a table showing certain funding information (i.e., the funding target attainment percentage, the funding shortfall and the minimum required contribution) for the plan year and each of the two preceding plan years with and without stabilization. The Department of Labor will be updating its model funding notice to reflect this requirement.

The relief provided by MAP-21 does not apply to plans using the yield curve rather than segment rates. (However, MAP-21 allows plan sponsors that previously elected to use the yield curve to revoke that election and change to the segment rates within a year of enactment without obtaining Treasury Department approval.)

The MAP-21 relief also does not apply for certain other purposes, including, for example, the calculation of PBGC variable rate premiums or mandated reporting under Section 4010 of ERISA, mandated interest rates for determining the value of lump sums and the relative value of benefit options, Internal Revenue Code ("Code") Section 415 benefit limitations, the maximum deductible contribution under Code Section 404 or determining excess pension assets for transfers to retiree health accounts under Code Section 420.

The relief provided by MAP-21 takes effect in the plan year beginning in 2012. However a plan sponsor may elect to delay the application of MAP-21 until the plan year beginning in 2013 either for all purposes or solely for the purposes of determining the applicability of benefit restrictions under Code Section 436.

PBGC Premiums

MAP-21 also increases PBGC premiums for both single employer plans and multiemployer plans.

For single employer plans, the flat rate premium increases from its current $35 per participant to $42 for plan years beginning in 2013 and $49 for plan years beginning in 2014. After 2014, these rates will be adjusted for inflation.

In addition, for plan years beginning in 2013 and thereafter, the variable rate premium, which is currently $9 per $1,000 of unfunded vested benefits, will be increased by $4 in the 2014 plan year (bringing it to a minimum of $13) and $5 in the 2015 plan year (bringing it to a minimum of $18). Beginning in the 2013 plan year, the variable rate premium will be adjusted for inflation, although it will be subject to a $400 per participant maximum on the variable rate premium. This $400 maximum will also be adjusted for inflation starting in the 2014 plan year.

Multiemployer plans, which have a lower guaranteed benefit and only pay a flat rate premium, will see the current $9 premium rise to $12 in the 2013 plan year. Beginning with the 2014 plan year, this amount will be indexed for inflation.

PBGC Improvements

MAP-21 adopts a number of governance changes including, for example, the establishment of a plan sponsor and participant advocate, quality control requirements (including peer review of its insurance modeling system), changes to the board of directors and other improvements.

Transfers of Excess Pension Assets

Background

Defined benefit pension plans are allowed to provide medical benefits to retirees on a tax-free basis through separate accounts within the plan. Provided that certain requirements are met, Code Section 420(b) allows defined benefit pension plans whose assets are at least 125% of the funding target and target normal cost to transfer (once per year) a limited amount of assets to a retiree medical account within the plan.

Extension and Expansion

MAP-21 extended the last day for making a retiree health account transfer from December 31, 2013 to December 31, 2021.

In addition, pension plans may now also transfer excess pension assets to an applicable life insurance account, which is a separate account used to fund retiree group term life insurance not exceeding $50,000. Most of the same rules applicable to retiree health account transfers also apply to the new life insurance account transfers, although the rules generally apply separately. Thus, for example, limits on the number of transfers per year apply separately to each type of transfer, as does the requirement that the employer maintain retiree benefits at the same level for the year of the transfer and the following four years.

Conclusion

Plan sponsors of single employer defined benefit pension plans should immediately discuss with their plans' actuaries the impact of MAP-21's pension funding stabilization rules, as they will likely have a short-term impact on plans' funding requirements.

This benefit will, of course, be offset to some extent by the increase in PBGC premiums for these plans. Multiemployer plans, which are unaffected by pension funding stabilization, will also have to plan for increased PBGC premiums.

Now that the retiree health account transfer rules have been extended through 2021 and expanded to include group life insurance, sponsors of plans that are fortunate enough to have excess pension assets in this difficult economic environment will be pleased to have alternative means of utilizing that excess.

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