**Newsbreak** — BENEFITS BRIEFING

DEAN ACTUARIES, LLC — July 6, 2012

5646 MILTON STREET, SUITE 210 DALLAS, TEXAS 75206 214-891-0990 FAX: 214-722-0101

# Pension Funding Relief Signed into Law

## Applies to 2112 Plan Years and After

On July 6th, the President signed transportation/student loan legislation (MAP-21) that included major changes in pension funding rules. The key impact of the new law on pension plans is:

- A ***significant reduction in the minimum funding requirement for 2012*** and smaller reductions in future years compared with current law.
- A significant increase in PBGC premiums starting in 2013

### How are pension contributions reduced – Interest rate stabilization

Under US law the funding requirement for a pension plan is based on a comparison of the Funding Target with plan assets. The Funding Target is the discounted value of benefits accrued to date determined using either a full bond yield curve (US AAA, AA, and A bonds) or a simplified bond yield curve comprised of three segment rates averaged over 24 months.

For 2012, in particular, segment rates were at historic lows. Low rates = larger liabilities = larger funding requirements.

**Prior Law Segment Rates for Calendar Year Plans (default rates)**

| Years | 2011 | 2012 |
|---|---|---|
| 1 - 4 | 2.94% | 1.98% |
| 5 -19 | 5.82% | 5.07% |
| 20 and up | 6.46% | 6.19% |

The new law puts a floor (and a ceiling) on these segment rates, based on a trailing *25-year* average of these rates (as opposed to the *24 month* average in current law)

The minimum/maximum corridor widens after 2012, reducing its impact.

**New Segment Rate Corridor**

| Year | Minimum/Maximum |
|---|---|
| 2012 | 90%/110% of 25-year average |
| 2013 | 85%/115% of 25-year average |
| 2014 | 80%/120% of 25-year average |
| 2015 | 75%/125% of 25-year average |
| After 2015 | 70%/130% of 25-year average |

The result of the corridor will be to set segment rates at 90% of a trailing 25-year average in 2012. That floor gets "lower" over 2013-2015, hitting "bottom" at 70% in 2016.

### Sponsors using the 'full yield curve' may opt in

The funding relief only applies if the sponsor is using 24-month average segment rates. If the sponsor has elected to use the 'full' spot-rate yield curve, it does not apply. Under the new law a sponsor may revoke such an election and opt to segment rates for 2012.

## How large is the effect on funding requirements for 2012?

The 25-year average segment rates have not been published but a Society of Actuaries study estimates that the average effect will be to increase segment rates for 2012 by about 1.36%. This in turn would increase the percentage of all pension plans with an 80% or higher Funding Target Attainment Percentage (funding ratio) from 62% to 92%. In 2012. The minimum funding requirement for 2012 would be reduced by about 43% for the average plan (of course, your plan is not likely to match the average).

We will have to wait for IRS to come out with "official" segment rates to prepare the 2012 actuarial valuation. But it's clear that for many employers this relief will be significant. Of course you may still contribute up to the maximum deductible amount, which does not change.

In subsequent years (after 2012), this relief will become less significant, as the floor is lowered. However, the new law is likely to provide meaningful relief to sponsors for 2013 and 2014 as well, and, if rates continue at their current low levels, relief will continue to provide somewhat lower contribution requirements through 2016. After 2016, the new law would only be useful if rates moved downward from current levels.

## Changing the FTAP/AFTAP

The new law relief will also affect the calculation of the AFTAP (the adjusted funding target attainment percentage) used to calculate funding-based benefit restrictions (e.g., the rule that limits a plan's ability to pay lump sums when the funded percentage is lower than 80%). Thus, benefit restrictions that would have applied under old law may not apply after interest rates are increased under the new law.

The new (“adjusted”) segment rates will ***not*** be used for several purposes:

- The maximum deductible contribution will use the old law segment rates
- PBGC premiums will be based on old law segment rates
- And lump sums will still be calculated on the old law segment rates.

Lump sums will be bigger than they would be if (adjusted) funding rules applied to their valuation.

## New disclosure requirement

For years 2012-2014, additional information must be included in the plan's annual funding notice for plans with a funding shortfall (determined without using the floor) that is greater than $500,000.

## Election to use "un-adjusted" rates for 2012

A sponsor may elect not to have adjusted segment rates apply to the 2012 plan year either: (1) for all purposes; or (2) solely for purposes of the funding-based benefit restriction rules.

## Increase in PBGC premium

Under prior law, the flat-rate premium for single employer DB plans was $35 per participant (the flat-rate premium is indexed for inflation). The per-participant variable rate premium was $9 per $1,000 of unfunded vested benefits divided by the number of participants (the variable rate premium is not indexed for inflation).

The new law increases the flat-rate premium by 20% to **$42** in 2013 and another 20% in 2014 to **$49**, with indexing thereafter.

The rate for variable-rate premiums (now **0.9%** of unfunded vested benefits) will increase to **1.4%** in 2014, **1.9%** in 2015, and be *indexed* thereafter. A $400 per participant cap (also indexed) is applied to the variable premium calculation.

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The new law provides significant relief for many DB plan sponsors. On the other hand, PBGC premiums will be higher starting next year.

**Dean Actuaries provides actuarial services, plan design, employee communication, retirement planning for employees, and customized investment education for employer-sponsored retirement plans.**

**www.retsource.com**
**deanco@retsource.com**