August 11, 2014

Act Quickly to Reduce Costs and Improve Funded Levels for 2013 and 2014 – Pension Funding Relief Extended

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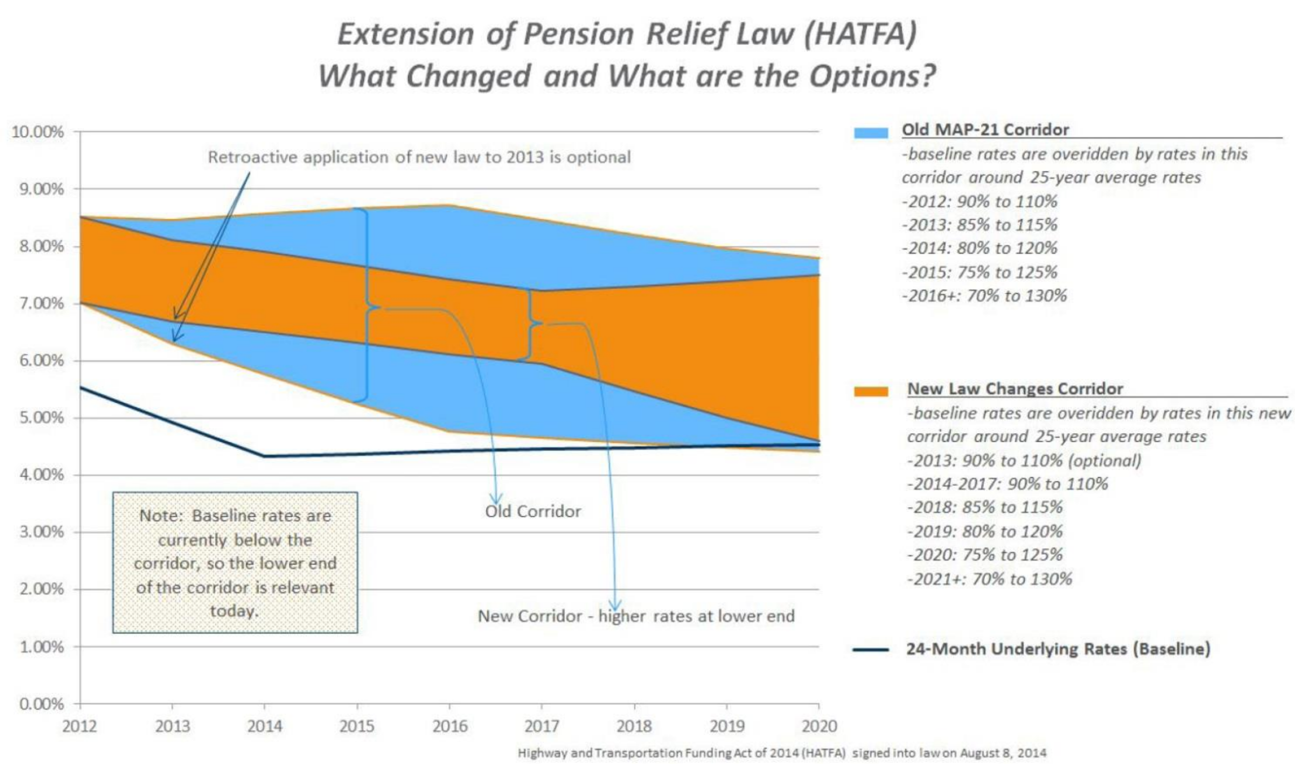
Plan sponsors of calendar pension plans can choose to reduce pension contribution requirements and show improved funded levels for 2013 if they act quickly. Revised 2013 calculations would be needed before the final contribution deadline of September 15, 2014. Also, reduced requirements and improved funded levels will apply for 2014, and actuarial certification of funded levels are required by September 30, 2014.

On August 8, 2014, the President signed the Highway and Transportation Funding Act of 2014 (HATFA). Part of the funding of this bill stems from the extension of pension funding relief for several more years. Corporations that sponsor pension plans will be allowed to set aside less cash for their plans, which increases profits and taxes.



Background

This relief was first provided by the Moving Ahead for Progress in the 21st Century Act (MAP-21) which was enacted in 2012. Under MAP-21, the relief was provided by requiring that the "segment rates" used to measure funding liabilities be within 90% to 110% of the 25-year average of segment interest rates defined under the Pension Protection Act of 2006 (PPA'06). This enables pension plans to use discount rates that are considerably higher than the current segment rates, resulting in substantial funding relief for many pension plans. However, the impact of MAP-21 quickly reduced the stabilization as the corridor expanded in 2013 and further in 2014.

Relief Extension

The new law extends the relief provided by MAP-21 by utilizing the 90% to 110% level of the stabilization for each of the years 2012 through 2017, and then gradually expands to a final corridor of 70% to 130% after 2020.

Timing Constraints

For many plans, the calculations, contributions, funded level certifications, and government filings for the plan year that began in 2013 have been completed. However, sponsors can choose to retroactively apply the newly extended 90% to 110% range to their 2013 plan year.

This new range is required to be used for plan years beginning in 2014 and later. Valuations that have been underway or possibly completed for 2014 will need to be revised to reflect the new rates. Since the 2014 calculations sometimes reveal opportunities and strategies for wrapping up 2013 funding, the 2014 revisions may be needed quickly to make informed decisions for the accrued 2013 contributions.

The 2013 minimum required contribution for calendar plan years is due by September 15, 2014, and the 2014 funded level certifications for calendar plan years are due by September 30, 2014. So there is little time for planning and revision of valuation calculations.

Extent of Cost Reduction and Funded Level Improvement

The segment rates under the new law that may be used for 2013 are roughly 30 to 40 basis points higher than MAP-21 segment rates, and the segment rates that will be used for 2014 are roughly 50 to 75 basis points higher. This translates into a reduction in minimum required contribution for the 2013 plan year, and an even greater reduction for the 2014 plan year. It also leads to increased funded levels for the 2013 plan year and even greater increases in the funded levels for the 2014 plan year.

The actual reduction in the minimum required contribution can vary significantly from plan to plan based on the plan's funded percentage, whether the plan is frozen or not, the existence and size of credit balances, the demographics of the plan, and other factors.

Actions Needed

Pension plan sponsors should talk with their actuaries now about the potential impact on their 2013 requirements, the extent of the work needed to revise prior results, the timing constraints for government filings, impact on plan audits, any elections that are necessary, etc. They should also talk about the revisions to their 2014 requirements and funded levels, and any impact that may have on their funding strategies.