

Congress delays phase-down of MAP-21 pension smoothing

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In brief

Both the House and the Senate have passed the Highway and Transportation Funding Act of 2014 (H.R. 5021, the '2014 Act'). The 2014 Act amends the pension smoothing provisions of the Moving Ahead for Progress in the 21st Century Act ('MAP-21') to delay the phase-down of the interest rate corridor. This change is expected to result in smaller required pension contributions for those employers who elect to take advantage of the relief, leading to smaller deductions and increased taxable income for such employers, thus raising the revenue necessary to address a looming shortfall in the Highway Trust Fund. Congress also expects the provision to increase revenues to the PBGC as a result of increased variable rate premiums for underfunded plans. The President is expected to sign the legislation.

In detail

Background

Certain interest rates are required to be used to determine minimum funding requirements for defined benefit plans. Under the Pension Protection Act of 2006, defined benefit plan liabilities are generally required to be valued using a set of three segment rates determined based on a yield curve that reflects a 24-month average of the yields on corporate bonds.

In view of historically low interest rates and the increased contributions they required, Congress enacted funding stabilization provisions in MAP-21. This Act stabilized interest

rates by requiring that each segment rate fall within a corridor of the 25-year average of the rates for that segment. Under MAP-21, in 2012 the interest rate for each segment of the yield curve must be within 10% of a 25-year average of prior segment rates. This 10% corridor was to be increased in 5% increments each year after 2012, becoming 15% for 2013, 20% for 2014, 25% in 2015 and 30% in 2016 and later years. Because the corridor gradually widens, the stabilizing effects of the provision are gradually phased down.

2014 Transportation Act

The 2014 Act modifies the pension smoothing provision of

MAP-21 by keeping the corridor around the 25-year average interest rates at 10% through 2017, for five years more than originally provided. The phase-down widening the corridor will commence in 2018, so that the corridor reaches 30% for 2021 and later years. The IRS publishes the applicable segment rates for each month; the segment rates in any month may not be less than the minimum percentage of the 25-year average segment rates, or more than the maximum percentage of the 25-year average rates.

The 2014 Act provides the following minimum and maximum percentages:

For years	Minimum percentage of 25-year average segment rates	Maximum percentage of 25-year average segment rates
2012 -2017	90%	110%
2018	85%	115%
2019	80%	120%
2020	75%	125%
2021 and later	70%	130%

Plan sponsors must use the amended rates for 2014, but may elect to keep the currently effective 15% corridor for 2013 either for all purposes, or solely for determining the adjusted funding target attainment percentage ('AFTAP') required in connection with the restrictions on benefits for underfunded plans. Anti-cutback relief is provided for plans making such an election, so that the election will not violate the requirements of Code Section 411(d)(6).

The adjusted segment rates will not apply for purposes of determining whether or not restrictions on prohibited payments (e.g., lump sums) apply to a plan during the

period when the sponsor is in bankruptcy. Such payments are only permitted to be made if the plan's AFTAP is at least 100%, determined without regard to the adjusted segment rates.

The annual funding notice to be provided to participants and beneficiaries must include certain disclosures concerning the MAP-21 rates when the plan's funding target using the 25-year average interest rates is less than 95% of the funding target determined without regard to the MAP-21 rates, if the plan has a funding shortfall greater than \$500,000. The Labor Department is directed to modify the required

statements to reflect the amendments made by the 2014 Act.

The takeaway

As a result of the 2014 Act, pension liabilities for 2013 may be recalculated—likely resulting in lower required contributions and a higher AFTAP. Plans may elect not to recalculate their 2013 liabilities, or to recalculate them just for purposes of the AFTAP and benefit restrictions. Plan sponsors should consider the benefit of such an election once the IRS provides guidance on the 2013 adjusted interest rates under the 2014 Act. The new provisions will apply to 2014.

Let's talk

For more information, please contact our author:

Anne Waidmann, *Washington, DC*
(202) 414-1858
birgit.a.waidmann@us.pwc.com

or your regional Human Resource Services professional:

US Practice Leader
Scott Olsen, *New York*
(646) 471-0651
scott.n.olsen@us.pwc.com

Charlie Yovino, *Atlanta*
(678) 419-1330
charles.yovino@us.pwc.com

Craig O'Donnell, *Boston*
(617) 530-5400
craig.odonnell@us.pwc.com

Pat Meyer, *Chicago*
(312) 298-6229
patrick.meyer@us.pwc.com

Terry Richardson, *Dallas*
(214) 999-2549
terrance.f.richardson@us.pwc.com

Todd Hoffman, *Houston*
(713) 356-8440
todd.hoffman@us.pwc.com

Carrie Duarte, *Los Angeles*
(213) 356-6396
carrie.duarte@us.pwc.com

Ed Donovan, *New York Metro*
(646) 471-8855
ed.donovan@us.pwc.com

Bruce Clouser, *Philadelphia*
(267) 330-3194
bruce.e.clouser@us.pwc.com

Jim Dell, *San Francisco*
(415) 498-6090
jim.dell@us.pwc.com

Scott Pollak, *San Jose*
(408) 817-7446
scott.pollack@Saratoga.PwC.com

Nik Shah, *Washington Metro*
(703) 918-1208
nik.shah@us.pwc.com

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