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Additional Pension Funding Relief is Here!

What does pension plan funding have to do with federal funding for infrastructure improvements? Quite a bit, actually. For the second time in three years, a law change was enacted to fund highway improvements. In order to pay for this, minimum funding requirements for pension plans were relaxed. Since pension plan contributions are tax deductible, lower pension plan contributions result in lower corporate tax deductions and more money to fund highways and other projects.

Background

The Pension Protection Act[1], generally effective in 2008, overhauled corporate pension plan funding in order to strengthen the financial condition of these plans through accelerated minimum required contributions. Pension liabilities were intended to be determined based on the most recent 24 month average of corporate bond rates. Soon after the law was effective, interest rates declined to historic lows and the stock market collapsed, resulting in significantly higher minimum required contributions.

In 2012, under the Moving Ahead for Progress in the 21st Century Act (MAP-21)[2], minimum pension funding relief was granted through the use of artificially higher pension liability interest rates. MAP-21 tied the interest rates to a 25 year average of bond rates, resulting in higher rates to measure the liability, hence lower liabilities and lower required contributions. The effect of this law change effectively was to be phased out by 2017.

Highway and Transportation Funding Act of 2014 (HATFA)[3]

On August 8, 2014, a second highway funding bill was passed that also contained pension funding provisions. The impact of the MAP-21 funding relief had diminished, so pension funding interest rates were further propped up under HATFA. The law is mandatorily effective for 2014 plan years and optionally for 2013 plan years. Similar to MAP-21, the impact of the law change is temporary, but is expected to lower minimum funding requirements from those under MAP-21 and extend the relief for an additional 4 years.

Impact of HATFA

Plan sponsors who have yet to make their final 2013 plan year contributions should consider adopting the HATFA rates for 2013. For 2013, interest rates under HATFA are generally 40 basis points higher than under MAP-21, which will lower plan liabilities by

[1] The Pension Protection Act of 2006, enacted August 17, 2006
[2] Moving Ahead for Progress in the 21st Century Act, enacted July 6, 2012
[3] The Highway and Transportation Funding Act, enacted on August 8, 2014

about 4-5%. For 2014, the impact is even greater – 2014 interest rates under HATFA are approximately 70 basis points higher than under MAP-21, which will lower liabilities by roughly 8-10%. For some plans, this will result in a funded percentage for 2014 in excess of 100%, which would mean substantially smaller or no minimum required contributions for the 2014 plan year.

Neither the MAP-21, nor HATFA, interest rates impact the level of maximum tax deductible contributions, PBGC premiums, ASC 715 accounting, or plan termination costs, all of which are tied to current interest rates. While the HATFA relief is welcome to plan sponsors, it is temporary and again pushes off required funding to future years. If interest rates rise as most people expect, the diminishing effect of HATFA will be tempered somewhat. Ultimately, plan sponsors should ascertain the appropriate level of plan funding based on a number of factors including company uses of cash, desirability of tax deductions, minimizing PBGC premiums, and whether there is a plan termination strategy.