The Bipartisan Budget Act of 2015

The Impact on Single-Employer Pension Plans

As the late Yogi Berra once said, “It’s like Déjà Vu all over again”! Congress passed and the President signed into law the Bipartisan Budget Act of 2015 (BBA 2015) on November 2, 2015. This law was passed in order to address the debt ceiling and federal government funding. In order to help accomplish these objectives, two revenue raisers from defined benefit plan sponsors were incorporated, including further increases in PBGC premiums and additional relaxation of minimum funding requirements, the latter of which is intended to lower tax deductible pension contributions thereby increasing federal revenue. The law also allows additional flexibility for setting pension funding mortality assumptions.

PBGC Premium Hikes

Premiums paid to the PBGC are seen as fees, rather than taxes, and therefore are an easy source of revenue for Congress to seek, even for purposes unrelated to the private pension system. In the Bipartisan Budget Act of 2013[1], significant increases in PBGC premiums were implemented on top of previous increases made as part of the Pension Protection Act of 2006[2]. Under the BBA 2015, Congress again increased PBGC premiums for single-employer defined benefit plans. Ironically, PBGC premiums cannot be used for anything other than to pay retirement benefits within the PBGC system, so increasing PBGC premiums essentially was a way to “balance the books.” In addition, higher PBGC premiums will continue to accelerate plan sponsor exits from the single-employer defined benefit system, so future premiums will decline as there are fewer and fewer plans and participants in the system.

Premiums for Single-Employer Plans can be broken down into two categories:

1. A flat dollar amount for every plan participant, and
2. A variable rate which is tied to the unfunded vested benefit liabilities of a plan.

The per participant premium is $64 for 2016 and had been scheduled to increase in future years with average wage growth. Under the new law, the per participant premium increases at a much higher rate than wage growth for the next few years - to $69 in 2017, $74 in 2018, and $80 in 2019 - and is indexed to wage growth thereafter.

The variable rate premium per $1,000 of underfunding is $30 for 2016 and was scheduled to increase in future years with average wage growth. Under the new law, the wage growth indexing still occurs but there is an additional increase of $3 for 2017, $4 for 2018, and $4 for 2019. As an example, assuming annual 2.5% wage growth indexing, the variable rate premium in 2020 would have been $33.12 under the prior law and would be $44.64 under the new law.

[1] Bipartisan Budget Act of 2013, enacted December 26, 2013
[2] Pension Protection Act of 2006, enacted August 17, 2006

There is a variable rate per participant premium cap affecting certain plans, which is $500 per participant for 2016 and indexed thereafter. The new law does not alter this premium cap, so some plans will not have additional variable rate premium increases in the near term over what they otherwise would have been.

In order to illustrate the impact of PBGC premium increases, the table below depicts a sample schedule of premiums for a plan with 500 participants, $26 million in plan assets and $30 million in vested benefit liabilities. In this example, the variable rate cap does not apply.

Effect of PBGC Premium Increases

Year	Unfunded Vested Liability	Per Participant Premium	Variable Rate Premium	Total	Total as % of Current Plan Assets
2016	$ 4,000,000	$ 32,000	$ 120,000	$ 152,000	0.58%
2017	3,700,000	34,500	125,000	159,500	0.61%
2018	3,400,000	37,000	132,000	169,000	0.65%
2019	3,100,000	40,000	136,000	176,000	0.68%
2020	2,800,000	41,000	125,000	166,000	0.64%

In the above illustration, premiums would increase even though the plan becomes substantially better funded over the period. If the plan did not become better funded, the PBGC premiums would further escalate.

Planning ahead for these premium increases is crucial for plan sponsors. Sponsors must consider ways to reduce these costs including additional pension funding and consideration of annuity or lump sum buyouts.

Minimum Pension Funding Changes

The Pension Protection Act, 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)[3], minimum pension funding relief was granted through the use of artificially higher pension liability interest rates. These higher rates lowered liabilities for purposes of determining minimum required contributions. At the time, the higher rates were expected to largely phase out by 2016.

[3] Moving Ahead for Progress in the 21st Century Act, enacted July 6, 2012

On August 8, 2014, the Highway and Transportation Funding Act of 2014 (HATFA)[4] was passed and added additional pension funding relief. This law further increased interest rates used for minimum funding, with the adjusted rates expected to largely phase out by 2021.

The BBA 2015 Act again extends this interest rate relief, resulting in higher interest rates than what would have occurred under HATFA until 2024. This will lower minimum required contributions for the next several years.

The BBA interest rates only affect the determination of minimum required contributions. They do not 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. Funding in excess of the minimum required contribution should strongly be considered, particularly given the increasing PBGC variable premium rates. Strategies such as borrowing to fund the pension plan, offering some level of lump sum cash outs to terminated vested participants, and annuity purchases for retirees also should be considered. Since every organization faces different challenges, and each pension plan's design, financial condition and demographics vary, there is not a "one size fits all" strategy. Each situation must be evaluated carefully.

[4] Highway and Transportation Funding Act of 2014, enacted August 8, 2014