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H.R. 3108: The Pension Funding Equity Act

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Summary

The House of Representatives passed H.R. 3108, the Pension Funding Equity Act by a vote of 336-69 on April 2, 2004. The legislation was approved by the Senate on April 8 by a vote of 78-19. President Bush signed the bill into law (P.L. 108-218) on April 10. The law makes several changes to the Internal Revenue Code (IRC) and the Employee Retirement Income Security Act (ERISA) with respect to funding requirements for defined benefit pension plans. Many of these plans experienced declines in the value of their pension fund assets as a result of the stock market decline from 2000 through 2002, and increases in the value of plan liabilities resulting from historically low interest rates. The law changes the interest rate used to calculate the present value of pension plan liabilities, temporarily reduces the amount of additional plan contributions required to be made by sponsors of underfunded plans (but only in certain industries), and makes changes to the schedule for amortizing investment losses incurred by some multiemployer plans.

Temporary Replacement of Interest Rate on 30-Year Treasury Securities with Interest Rate on Conservatively Invested Long-Term Corporate Bonds. The Internal Revenue Code requires defined benefit pension plans to use the interest rate on 30-year U.S. Treasury Bonds (1) to determine the funded status of a defined benefit plan, (2) to calculate the amount of lump-sum distributions to plan participants, and (3) to determine maximum benefit amounts. Under the terms of the Job Creation and Worker Assistance Act of 2002 (P.L. 107-147), plan sponsors were permitted to use an interest rate equal to 120% of the four-year average interest rate on long-term Treasury bonds for these purposes. The Treasury Department stopped issuing 30-year bonds in September 2001, and statutory authority to use an interest rate tied to the Treasury bond rate expired on December 31, 2003.

P.L. 108-218 replaces the interest rate on 30-year Treasury bonds with an interest rate based on the average rate of return on high-quality long-term corporate bonds for plan years beginning in 2004 and 2005. For determining whether the plan meets minimum funding requirements, the maximum permissible interest rate is the weighted average of conservatively invested long-term corporate bond rates during the four-year period ending on the last day before the beginning of the plan year. Employers can elect to disregard the interest rate replacement for purposes of calculating the maximum deductible contribution

to the pension plan. The calculation of lump-sum distributions to plan participants is not affected by the change in interest rates during the two-year period that the law will be in effect. Pursuant to the changes in the tax code made by P.L. 108-218, on May 3, 2004, the Treasury Department published Notice 2004-34, which notified taxpayers of the change in interest rates to be used to calculate minimum plan funding under Internal Revenue Code section 412.

The interest rate used to determine maximum permissible benefits under a defined benefit plan is 5.5% for plan years beginning in 2004 and 2005. A transition rule provides that for 2004, the maximum will not be less than the maximum amount determined using the interest rate in effect on the last day of the preceding plan year.

Election of Alternative Deficit Reduction Contribution (DRC). Pension plans that are less than 90% funded (i.e., that have a funding deficit of more than 10%) are required by law to make "deficit reduction contributions" to the pension plan. The amount of the contribution is based on the plan's current liabilities, as determined using a specific rate of interest and an approved mortality table. Under P.L. 108-218, some employers can elect temporary relief from required deficit reduction contributions for plan years beginning after December 27, 2003, and before December 28, 2005. Only plans that were not subject to the deficit reduction contribution in 2000 qualify for this relief. Commercial airlines, steel producers, and the Transportation and Communication Workers' Union staff plan automatically qualify for the relief, unless they were subject to the DRC in 2000. Companies that qualify for DRC relief still will be required to make the "regular contribution" that the company would have to make without regard to the DRC provision, but the required DRC will be reduced by 80% in 2004 and 2005. Companies are prohibited from increasing benefits during the lifetime of the relief, unless

- the plan's actuary certifies that the amendment provides for an increase in annual contributions that will exceed the increase in annual charges to the funding standard account that are attributable to the amendment; or

- the increase is required by an existing collective bargaining agreement.

Employers who elect relief from DRCs must notify participants, beneficiaries, and the Pension Benefit Guaranty Corporation (PBGC). The notice to participants must include the amount of relief and information about PBGC benefit guarantees. The notice to the PBGC must include the amount of the relief, the expected number of years before the plan will be fully funded, and a comparison of the amount of underfunding to the company's capitalization.

Multiemployer Plan Funding Notices. Most companies that sponsor pension plans for their employees do so as the sole sponsor of the plan. In some industries, however, it is common for employers to jointly sponsor plans for their workers. These are called "multiemployer plans." Many trucking companies, for example, participate in multiemployer plans, and many members of the Teamsters' Union are covered under multiemployer pension plans. Under the Pension Funding Equity Act, the administrator of a multiemployer defined benefit plan must provide an annual notice to participants, beneficiaries, labor organizations representing participants, and employers contributing to the plan that includes

- a statement that the plan's current liability funded percentage is at least 100% or, if less than 100%, the actual funded percentage;
- the value of assets and benefit payments, and the ratio of assets to benefit payments;
- a summary of the rules that govern insolvent multiemployer plans, including the limitations on benefit payments and any potential benefit reductions or suspensions; and
- a description of PBGC guaranteed benefits.

Amortization Hiatus for Net Experience Losses in Multiemployer Plans. In a typical defined benefit plan, 50% or more of the assets held by the plan are invested in stocks. The three-year decline in the stock market from 2000 to 2002 therefore resulted in substantial losses in the value of the assets held by pension funds. Differences between the expected return on assets in a pension plan and the actual return on assets are called "experience losses" (or gains). Experience losses (and gains) are amortized beginning in the year after they occur. Under P.L. 108-218, some multiemployer plans may elect to delay the start of the 15-year amortization period for "experience losses" for up to three years. The election can apply to losses for any two plan years beginning after June 30, 2002, and before July 1, 2006.

Plans that elect relief from amortizing experience losses will have to notify participants, beneficiaries, labor organizations representing participants, and employers contributing to the plan of the relief election. The notice must include the amount of payment being deferred and the maximum PBGC guaranteed monthly benefit if the plan were to terminate while underfunded. The law establishes a five-part test for multiemployer plans seeking to delay the amortization of net experience losses. Under the test, a multiemployer plan

- must have had a net experience loss of 10% or more in 2002;
- must be certified by the plan's actuary as expected to have a funding deficiency in 2004, 2005, or 2006, based on the actuarial assumptions for plan year 2003;
- must have paid on time any excise tax imposed by the Internal Revenue Service;
- must not have had a plan year after June 30, 1993, when the average contribution required of all employers was less than 10 cents an hour; and
- must not have previously received a funding waiver from the Internal Revenue Service.

During the delay in the start of the amortization period, a multiemployer plan may not increase benefits unless the benefit increase has already been negotiated under an existing collective bargaining agreement or unless contributions to the plan exceed the annual charges attributable to the benefit change. In additions, the plan's actuary must certify that the contributions exceed the charges to the plan.

Two-Year Extension of Transition Rule to Pension Funding Requirements. Section 1508 of the Taxpayer Relief Act of 1997 (P.L. 105-34) allows the pension plan of Greyhound bus lines to be treated as fully funded for plan years beginning before 2005 if the funded current liability percentage is at least 85% (instead of 90%, as applies to most plans.) Under the new law, the Greyhound/Amalgamated

Transit Union pension plan can use a specialized mortality table in calculating the funding liability to its defined benefit plan in 2004 and 2005, and will be exempted from the deficit reduction contribution and variable PBGC premiums in 2004 and 2005.

Procedures Applicable to Disputes Involving Pension Plan Withdrawal Liability. In a multiemployer plan, plan liabilities are shared by the companies that sponsor the plan. A company that withdraws from the plan must pay a proportion of the plan's outstanding liability. If the withdrawing company is a subsidiary of a parent company, the parent company may be responsible for paying part of the subsidiary's withdrawal liability unless it can prove that the subsidiary was not created for the purpose of evading withdrawal liability. Under the new law, the burden of proof that a subsidiary was created to avoid termination liability is shifted from the employer to the multiemployer plan if the transaction occurred before January 1, 1999, and the employer did not received notice of a claim before October 31, 2003. The employer also is not required to start making payments of withdrawal liability before a final court or arbitration decision had been issued.

Extension of Transfers of Excess Pension Assets to Retiree Health Accounts. Under prior law, an employer that sponsors a defined benefit pension that has excess assets is permitted to use some of those assets to fund retiree health benefits. This authority would have expired on December 31, 2005. The Pension Funding Equity Act extends the authorization to use some excess pension assets to fund retiree health benefits through December 31, 2013.

Repeal of Reduction of Deductions for Mutual Life Insurance Companies. The new law repeals section 809 of the Internal Revenue Code, relating to reductions in certain deductions for mutual life insurance companies.

Clarification of Exemption from Tax for Small Property and Casualty Insurance Companies. The new law treats certain small insurance companies as tax-exempt organizations under section 501(c) of the Internal Revenue Code.

Confirmation of Antitrust Status of Graduate Medical Resident Matching Programs. The new law confirms that federal antitrust laws do not prohibit medical schools from sponsoring, conducting, or participating in a graduate medical education residency matching program, or agreeing to do so and ensures that institutions that sponsor, conduct, or participate in such matching programs will not be subjected to the burden and expense of defending against litigation that challenges such matching programs under the antitrust laws.