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INSIGHT

Proposed Extension of Interest Rate Stabilization Percentages for Single Employer Plans

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Participants in defined benefit (DB) pension plans typically receive monthly payments from the plans when they retire. Employers that sponsor these plans set aside an amount each year to fund the benefits that will be paid. The benefit obligations are a plan liability spread out over many years in the future.

Pension Plan Benefit Calculations

A DB plan's future benefits are spread out many years in the future and are calculated and reported as present values (also called current values) through a process called discounting. Discounting requires the use of a specified interest rate and uses a formula to express benefits that are expected to be paid in a particular year in the future as a present value. Discounting is the inverse of compounding, which projects how much a dollar amount will be worth at a point in the future given a specified interest rate.

The formula for calculating a present value is:

$$\text{Present Value} = \frac{\text{Dollar Value of Future Benefit}}{(\text{Interest Rate})^{\text{Number of Years in the Future}}}$$

The present value of a dollar amount is inversely related to both the interest rate (also called the discount rate) used to determine the present value of future cash flows and the number of years in the future used in the calculation. As the interest rate rises, the present value of future benefit obligations decreases, and DB pension plan sponsors' contributions decrease while maintaining plan funding. When pension plan contributions decrease, employers' taxable income increases, which results in increased revenue for the U.S. Treasury.

Under current law, this present value formula uses three separate interest rates, referred to as segment rates, which are calculated as the average of the corporate bond yields within each segment for the

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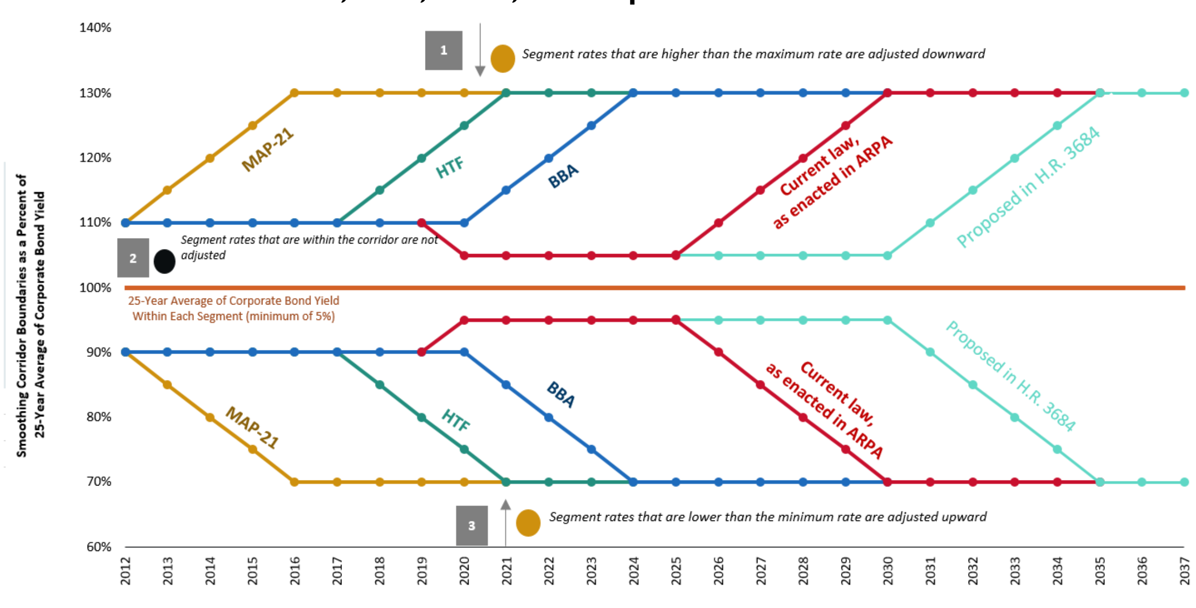
preceding 24 months. The first segment is for benefits payable within five years, the second segment is for benefits payable after five to 20 years, and the third segment is for benefits payable after 20 years.

In 2012, in order to mitigate increasing employer DB contributions resulting from low interest rates, the Moving Ahead for Progress in the 21st Century Act (MAP-21; P.L. 112-141) created a mechanism, called a funding corridor, to determine the minimum and maximum pension plan interest rates as a percentage below and above the 25-year average of historical corporate bond yields. The resulting increase in U.S. Treasury revenue was used as a budgetary offset for MAP-21.

Figure 1 shows the funding corridor. If the 24-month segment interest rate is higher than the maximum (point 1), it is adjusted downward to the maximum. If the segment rate is within the corridor (point 2), the rate is not adjusted. If the 24-month segment interest rate is below the minimum percentage of the funding corridor (point 3), the interest rate is adjusted upward to the minimum.

The funding corridor was originally scheduled to widen in 2013, which would have resulted in lower floors and higher ceilings. Since MAP-21, subsequent legislation has extended the years in which the funding corridor widens, most recently in the American Rescue Plan Act of 2021 (ARPA, P.L. 117-2). Section 80602 of H.R. 3684, the Infrastructure Investment and Jobs Act, as passed by the Senate on August 10, 2021, would delay the widening of the interest rate corridor until 2031, as shown in **Figure 1**.

Figure 1. Hypothetical Application of Interest Stabilization Provision, as Found in MAP-21, HTF, BBA, ARPA, and Proposed in H.R. 3684



Source: Congressional Research Service.

Notes: MAP-21 = Moving Ahead for Progress in the 21st Century Act (P.L. 112-141); HTF = Highway and Transportation Funding Act of 2014 (P.L. 113-159); BBA = Bipartisan Budget Act of 2015 (P.L. 114-74); ARPA = American Rescue Plan Act of 2021 (P.L. 117-2). The segment rates are calculated as the average of the corporate bond yields within the segment for the preceding 24 months. The three segment rates are calculated as the average of the corporate bond yields for the preceding 24 months with maturities of (1) less than five years, (2) five to 20 years, and (3) more than 20 years, respectively.

In **Figure 1**, the orange line shows the 25-year average of corporate bond yields within a segment. The gold, green, and blue lines indicate the minimum and maximum rates around the 25-year average under MAP-21 and two extensions—the Highway and Transportation Funding Act of 2014 (P.L. 113-159) and the Bipartisan Budget Act of 2015 (P.L. 114-74). The red lines indicate the minimum and maximum rates around the 25-year averages under current law as outlined in ARPA. ARPA also set a floor of 5% for the 25-year average of corporate bond yields. The dark teal lines indicate the maximum and minimum rates around the 25-year average as proposed in H.R. 3684. The funding corridor would remain at the current floor of 95% and the current ceiling of 105% through 2030. In 2031, the corridor would begin widening.

Interest rates are currently—and likely will be for the foreseeable future—below the 5% floor (thus adjusted upward to the floor). A widening corridor results in a progressively lower floor for the adjusted interest rate, which increases the present value of future benefit obligations and causes required plan contributions to increase.

Delaying the widening of the corridor means that the present value of future benefit obligations does not increase until a later specified date, and companies do not have to increase their required plan contributions until that point. Lower plan contributions increase companies' taxable income, which results in increased Treasury revenue. JCT estimated that this provision would result in a net increase of $2.9 billion for the U.S. Treasury. For more information on the funding corridor, see CRS Report R46366, *Single-Employer Defined Benefit Pension Plans: Funding Relief and Modifications to Funding Rules*.

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