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Significant Single-Employer DB Funding Relief Signed Into Law

March 2021

On March 11th, President Biden signed into law the American Rescue Plan Act of 2021. The $1.9 trillion COVID-19 related relief package includes some of the most meaningful funding relief for single-employer defined benefit (DB) plans since the Pension Protection Act of 2006. The new law significantly lowers the minimum funding requirements and makes benefit restrictions less likely for many DB plans covered under ERISA.

In brief, the new law:

- provides additional and long-term interest rate stabilization which raises the interest rates otherwise used to determine minimum required contributions and benefit restrictions.
- removes current amortizations for pension underfunding and replaces them with a new 15-year amortization (instead of seven), providing more time for plan sponsors to fund their plan.

The new law also gives flexibility to a plan sponsor as to when these changes take effect. While the new interest rates and amortization fresh-start are required for plan years beginning in 2022, a plan sponsor may elect to apply the new interest rates beginning in 2020 (or possibly beginning in 2021, depending on the interpretation of language in the law), and could separately choose to use the amortization fresh-start in any year beginning in 2019. For plan sponsors with significant contribution requirements, retroactively applying all or some of these provisions to January 1, 2020 could impact cash contributions required to be made in calendar year 2021 and may immediately impact plans operating under benefit restrictions.

FUNDING RELIEF DETAILS

The funding relief focuses on:

(1) continuing and enhancing interest rate relief provided under previous funding relief legislation, and
(2) allowing sponsors more time to restore their plans to full funding.

The law is very similar to the provisions in the HEROES Act passed by the House in 2020, which itself mirrored several ideas previously offered by the American Benefits Council (ABC).

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Extending Interest Rate Relief

In 2012, the Moving Ahead for Progress in the 21st Century Act ("MAP-21") introduced to pension funding the concept of interest rate "stabilization", where the two-year average of corporate bond rates – previously used to determine plan liabilities and minimum contributions – would be adjusted to be within 10% of the 25-year average of corporate bond rates. This approach had the effect of bringing into the interest rate calculation the much-higher rates of the late-1980s and 1990s, substantially increasing interest rates used for funding calculations – and thus lowering liabilities and minimum required contributions.

Under MAP-21, this 10% corridor would begin to gradually phase out starting in 2016. Later legislation delayed the start of the phase out until 2021, with the 10% gradually increasing to an ultimate level of 30% by 2024.

The new pension relief makes several changes to the interest rate calculation:

- The 10% corridor is lowered to 5% of the 25-year average corporate bond rate beginning in 2020.
- The beginning of the phase-out is delayed, again, to 2026, with the ultimate level of 30% now not reached until 2030.
- A 5% floor is placed on the 25-year interest rates (before application of the corridor), potentially dampening the effect of some of the higher 1990s rates dropping out of the 25-year average over time. In effect, this means that for 2020 through 2025, funding segment interest rates will not be lower than 4.75%, and in the long-term – 2030 and beyond – rates will be "floored" at 3.50%.

	Interest Rate Corridor Under:	
Year	Prior Law	New Law
2020	10%	5%
2021	15%	5%
2022	20%	5%
2023	25%	5%
2024	30%	5%
2025	30%	5%
2026	30%	10%
2027	30%	15%
2028	30%	20%
2029	30%	25%
2030+	30%	30%

For a typical pension plan, the corridor change alone could increase the plan's effective interest rate for 2021 by approximately 60 basis points, reducing liabilities (and improving funded status) by 7% - 9%. Because the new law will keep the corridor level at 5% until 2025, whereas the prior law would have increased it, the impact of the new law on the effective interest rate will increase over the next four years when compared to the prior law.

In addition to being used to determine minimum required contributions, these rates would also be used to calculate a plan's Adjusted Funding Target Attainment Percentage, or AFTAP. Plans that offer lump sums to participants must maintain an AFTAP of at least 80% to pay those lump sums in full. These rates

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will reduce liabilities and in turn increase the AFTAP, making it easier for plans to continue to allow lump sum payments.

A Fresh Start on Underfunding

The above changes address the impact of the current, historically low, interest rate environment on the liability used to determine minimum required contributions. To provide further contribution relief, the new relief creates a "fresh start" for amortizing pension underfunding. This is done by eliminating all existing funding shortfall amortization bases and charges no later than the first plan year beginning after December 31, 2021 and then amortizing any new or existing funding shortfall over fifteen years rather than seven.

A Myriad of Plan Sponsor Elections – And Some Uncertainty

While there are certain dates at which these new provisions must be applied, these dates are not all uniform. The funding relief provides plan sponsors with choices to implement the relief sooner – and in some cases, implement only certain aspects of the relief in earlier years. Unfortunately, with these elections, there is also some uncertainty in the law's language as to applicable dates for various elections. These choices, and available options, as we understand them are summarized in the table below:

Funding Relief Provision	For Plan Years Beginning on or After		
	Required	Optional	Default*
Interest rate relief	2022	Apply for minimum and AFTAP: 2020, 2021** Apply for minimum only: 2020, 2021**	2020
Fresh-start amortization	2022	Start using as early as 2019, 2020 or 2021	2022

**Default, if no election made by plan sponsor*
*** Unclear based on language if this option can be elected beginning in 2021*

In reading the language with respect to the interest rate relief election, there could be different interpretations of the available options:

- A plan sponsor can only opt out of using the new rates for *both* 2020 and 2021. With this interpretation, a sponsor who wants to use the new rates for their 2021 valuation would need to use them for 2020 as well. This may result in sponsors who have little to gain from reflecting the new rates in both 2020 and 2021 delaying their use of the new rates until 2022.

- A plan sponsor can opt out of using the new rates for *either* 2020 or 2021. Theoretically, this means that a sponsor could elect to use the new rates for 2020 but not 2021, although it's difficult to imagine a circumstance where such an election would be beneficial. The more important point is that a sponsor who has little to gain from applying the new rates to 2020

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could instead choose to begin reflecting the new rates in 2021, thus avoiding having to re-do their 2020 valuation.

- A plan sponsor can opt to *begin* using the new rates for plan years *beginning* in 2020 or 2021. This is slightly different from the second interpretation described above, in that if a plan sponsor elects to use the rates in 2020, they would also be required to use them in 2021. (In other words, there would be no ability to use the rates for 2020 but not 2021.) Like the second interpretation, this would allow plan sponsors who have limited benefit from re-doing their 2020 valuations to begin reflecting the new rates in 2021.

Rep. Richard Neal, Chairman of the House Ways and Means Committee, issued a statement when the House passed the legislation that the intention in drafting was the third interpretation described above. However, further regulatory confirmation of this may be needed.

To be clear, a plan sponsor can choose different effective dates for the interest rates for minimum contribution requirements vs. AFTAP calculations. This flexibility is likely to be of value only to plan sponsors who are concerned about the administrative implications of retroactively adopting new interest rates for AFTAP purposes which would result in a change in the plan's ability to pay lump sums.

Assuming that the third interpretation is correct and that sponsors can elect to begin using the new rates in 2020, 2021, or 2022, we believe most plan sponsors will fall into two categories:

Category **1**

Sponsors electing all aspects of the relief to apply for 2020. While this would require redoing the 2020 actuarial valuation, sponsors with final 2020 plan year contribution requirements (e.g., the September 15, 2021 wrap-up contribution for plans with calendar-based plan years), or sponsors facing benefit restrictions imminently, may generate meaningful benefit from applying the relief in 2020.

Category **2**

Sponsors electing all aspects of the relief to apply for 2021. Well-funded plan sponsors who had no minimum contribution requirement for 2020 can avoid re-doing their 2020 valuation by instead electing to apply the new rules in 2021. Given most 2021 valuations are still to be completed, most will see little value in delaying the effective date until 2022.

OPEN ISSUES

Beyond the issue of the interest rate election outlined above, not surprisingly we will likely need regulatory guidance to address other certain operational implications of the new relief. For example:

- For plan sponsors who now elect to apply relief for 2019 or 2020, what happens to credit balances already applied to the 2019 or 2020 minimum required contributions? Given these minimums are reduced under the new law, will those credit balances be restored? Previously the IRS has provided guidance allowing a sponsor to unwind applications of credit balance beyond the minimum requirements.

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- What will plan sponsors be required to show on the Annual Funding Notice (due by April 30th, 2021 for 2020 calendar year plans)? Interest rate relief as a default is effective for the 2020 plan year, so will they need to reflect the new 2020 interest rates if they have not made a final decision on which rates to use?

- For sponsors subject to PBGC 4010 requirements, this relief does not impact whether a plan is subject to such a filing. However, valuation reports are required to be attached. Sponsors who have not actually made an election otherwise or want to use the new rates for 2020 may need to attach "old" 2020 valuation reports to the filing, since reports reflecting the new interest rate relief would be unlikely to be completed before the filing deadline (April 15th).

NEXT STEPS

Plan sponsors should begin working with their plan actuary to review the impact on their recent valuation results to decide when the new provisions of the new law should be reflected. Further clarification from regulatory agencies on the appropriate interpretation of the interest rate election language will be an important aspect of plan sponsor decision-making on this front.

While the new rules will lower contribution requirements for many sponsors, it will also likely extend the amount of time until the plan is restored to full funding. This delay could mean paying greater PBGC variable rate premiums for a longer period of time. As a result, following these new minimum requirements may not mean paying less in the long-term.

This trade-off will be analyzed in more detail in a future publication. In the meantime, we would recommend working with an actuarial consultant to determine the appropriate funding strategy for your plan given your funded status, investment strategy, and organization-wide factors.

For more information

For more information on this topic, please contact your Fidelity Relationship Manager or contact us directly.

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