

Pension Funding Equity Act of 2004 Provides Plan Funding Relief

WHO'S AFFECTED The new law affects all qualified defined benefit plans that are subject to ERISA minimum funding rules. Governmental plans and nonelecting church plans are not subject to these rules.

BACKGROUND AND SUMMARY The Pension Funding Equity Act of 2004 (PFEA), which was signed into law on April 10, 2004, provides *temporary* defined benefit plan funding relief for plan years beginning in 2004 and 2005. Some provisions have different effective dates.

Defined benefit plan funding is affected by the relationship of plan assets and liabilities. One of the measures of liability is the plan's "Current Liability," which is based on IRS-prescribed interest rates. Until now, that rate had been based on the 30-year Treasury bond rate.

In October 2001, the Department of Treasury announced it was no longer issuing 30-year Treasury bonds. Since that time, the IRS has been publishing the monthly yields on the 30-year Treasury bond based on a maturity date of February 2031. This rate has significantly decreased over the last several years. The lower rate has, in some cases, caused defined benefit plans to appear to be underfunded and, as a result, require larger contributions to the pension plan. In an effort to correct this, the Job Creation and Worker Assistance Act of 2002 (JCWAA) was enacted and provided temporary funding relief for plan years beginning in 2002 and 2003. (See our April 2002 publication titled, "[Economic Stimulus Bill Provides Funding Relief for Defined Benefit Plans and Technical Corrections to EGTRRA](#)")

PFEA picks up where JCWAA left off. In addition, the new legislation provides other temporary relief related to defined benefit funding, including notice requirements for certain plans. Unless additional legislation is enacted, the funding relief rules will expire in 2006.

ACTION AND NEXT STEPS No plan amendments are required. However, a plan amendment may be needed for the change related to the maximum annual benefit. If you have questions about how this funding relief affects your plan, you should contact your plan's enrolled actuary.

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All Defined Benefit Plans

PFEA provides funding relief to all qualified defined benefit plans that are subject to ERISA. The relief varies by type of plan sponsor. The following provisions apply for plan years beginning in 2004 and in 2005 only, unless otherwise noted.

Interest Rate for Plan Funding

For purposes of determining plan funding, PFEA replaces the 30-year Treasury bond rate with a composite long term corporate bond rate. The IRS will develop this rate, every month, based on two or more high quality long term corporate bond indices that are available in the top three quality levels. Since the new rate will generally be higher than the old 30-year Treasury rate, plan liabilities should decrease and fewer plans should find themselves with funding problems. On the last page of this publication, we have included a [chart](#) illustrating the changes in the interest rate structure for plans that have calendar plan years.

Current Liability Calculation

PFEA also changes both the required interest rate and the permissible range of interest rates used for determining a plan's current liability. The end result of this combination of changes should be to reduce many plans' current liability.

The required interest rate is now a weighted average of the monthly composite long term corporate bond rates for the four-year period ending on the last day before the beginning of the applicable plan year. The IRS has already published [Notice 2004-34](#) to provide interim guidance for determining the new rate.

When selecting an interest rate to use in the current liability calculation, a plan may use an interest rate of no less than 90% and no more than 100% of the four-year weighted average bond rate.

Maximum Allowable Deductible Contribution

In general, plan sponsors will use an interest rate that is within the new permissible range of interest rates, [described above](#), for determining the maximum allowable deductible contribution. However, for 2004 and 2005, an employer may use the old interest rate rules (90%-105% of the four-year weighted average of 30-year Treasury bond rate) for determining the maximum allowable deductible contribution. Use of this alternative may result in a larger tax deduction for the employer since the old rules will likely create a larger current liability amount.

Maximum Annual Benefit

A plan must adjust the annual benefit limit (\$165,000 for 2004) if a participant takes a form of payment other than a single life annuity or a qualified joint and survivor annuity (QJSA). If a single sum payment (or certain other forms of payment) is made, the plan must use an interest rate equal to the greater of the rate specified in Code section 417(e)(3) or the rate specified in the plan when making this adjustment. In recent years, this requirement has sometimes resulted in the payment of larger single sum payments. While this result has been beneficial for participants, it has put an additional squeeze on plan funding.

For plan years beginning in 2004 and 2005, PFEA replaces the fluctuating Code section 417(e)(3) rate, as noted above, with a rate of 5.5%. This change could produce lower single sum payment amounts in some situations.

Plan documents that simply cross-reference the Internal Revenue Code section 415 provisions will not have to be amended to reflect this change; it will automatically apply. However, plan documents that do not cross-reference section 415 must be amended to take advantage of the new interest rate limit. If a plan sponsor adopts this amendment by the last day of the 2006 plan year, the change may be applied retroactively to 2004. If we provide document services for your plan, we will contact you with further information about the need to amend your plan document.

While benefit amounts determined under these new rules may be less than they would have been under the old rules, the law provides that this reduction will not be considered a violation of the anti-cutback rules. However, benefits payable in 2004 cannot be less than what they would have been based on the old rules.

Single Employer Plans

The following provisions generally apply only to single employer plans for plan years beginning in 2004 and in 2005 only, unless otherwise noted.

Deficit Reduction Contributions

A defined benefit plan sponsor may be required to make additional contributions (“Deficit Reduction Contributions” or “DRC”) if plan assets are between 80% and 90% of the current liability in the current plan year. If a plan is less than 90% funded in the current year, a plan may look back to earlier years to determine if additional contributions are required in the current year.

PFEA does not change the rules for determining when additional contributions are required. However, a plan that looks back to earlier plan years to determine if additional funding is required in the current year, may redetermine its funded status for those earlier years using the new current liability interest rate described above. [IRS Notice 2004-34](#) also provides the new interest rates for years prior to 2004.

In addition, PFEA permits commercial passenger airlines, steel and related iron ore companies, and the Transportation and Communication Workers’ Union staff plan to defer making a portion of the additional required contribution for as much as two years. In general, plans electing this option may defer payment of up to 80% of the DRC required during the two-year period. In most situations, plan sponsors electing this relief may not increase benefits during the two-year period, and special notice must be provided to plan participants, beneficiaries, labor organizations, and the

Pension Benefit Guaranty Corporation (PBGC). [IRS Announcement 2004-38](#) provides procedures for electing this relief.

Quarterly Contribution Requirement

Quarterly contributions must be made if a plan fails to meet certain funding rules. Again, PFEA does not change this requirement. However, the new interest rate rules used for determining a plan's current liability, as described above, are used to determine a plan's funding requirements.

To determine whether quarterly contributions are due for a plan year, a plan must look back to the prior plan year's funded status (plan assets vs. current liability). If the plan's prior year funded status was at least 100% (i.e. plan assets are equal to or greater than current liability), then no quarterly contributions would be due for the current plan year.

PFEA includes a special rule for plan years beginning in 2004. Under old law, a plan would have had to recalculate its 2003 funded status using an interest rate no greater than 105% of the four-year weighted average of the 30-year Treasury bond rate, just to determine if quarterly contributions are applicable in 2004. PFEA permits a plan to use the existing 2003 plan year information to determine whether 2004 quarterly contributions are due and in what amount. It also allows plans to rely on the new interest rate rules and recalculate the 2003 current liability amount if that will increase the plan's funded status to 100%. As a result of these changes, quarterly contributions that otherwise would have been required may be entirely eliminated.

PBGC Variable Rate Premium Calculation

The interest rate for determining the plan's variable premium that is payable to the PBGC, will be based on the composite corporate bond rate determined by the IRS, [described above](#). In determining the PBGC variable premium that is due for plan years beginning in 2004 and 2005, the interest rate will be 85% of the composite long term corporate bond yield for the month preceding the first day of the applicable plan year.

Transfer of Excess Pension Plan Assets to Retiree Health Accounts

Plans may continue to transfer excess pension plan assets to retiree health accounts, commonly called *Section 420 transfers*. This capability had been scheduled to expire on December 31, 2005, but will now be available until December 31, 2013.

Multiemployer Plans

The following provisions apply only to multiemployer plans.

Required Plan Funding Notices

Starting with plan years beginning after December 31, 2004, a multiemployer plan administrator must provide a plan funding notice to certain interested parties no more than two months after the deadline (including extensions) for filing the plan's Form 5500. The notice must be provided to plan participants, beneficiaries, labor organizations, each employer that is obligated to contribute to the plan, and the PBGC. PFEA describes the required content of the notice and prescribes penalties that may be enforced for failure to provide timely notices. The Department of Labor will issue regulations by April 10, 2005. For plans with calendar plan years, September 30, 2006, would be the earliest due date for the first plan funding notice.

Plan Funding Relief

An eligible multiemployer plan may defer up to 80% of the minimum funding charges related to net experience loss for any plan year beginning after June 30, 2003, and before July 1, 2005, to either of two plan years immediately following.

Eligible plans include those plans that experienced a net investment loss for the first plan year beginning after December 31, 2001, of at least 10% of the average fair market value of plan assets, where an enrolled actuary certifies that the plan will have a projected funding deficiency for any plan year beginning after June 30, 2003, and before July 1, 2006. Other conditions must be met to be an eligible plan.

Any plan that elects this relief may not increase benefits during the deferral years unless (1) the enrolled actuary certifies that additional contributions to the plan as a result of the benefit increase will cover the increased cost for the benefit change or (2) the plan is subject to a good faith collective bargaining agreement that was in effect on April 10, 2004.

In addition, a plan that elects this relief must provide written notice within 30 days of filing the election to plan participants, beneficiaries, labor organizations, each employer that is obligated to contribute to the plan, and the PBGC. PFEA describes what must be contained in the notice and addresses penalties that may be enforced for failure to provide timely notices.

Other Pension Funding Related Changes

PFEA addresses the need for Congress to ensure the financial health of defined benefit pensions. Congress's goal is to provide for a permanent replacement of the 30-year Treasury rate and comprehensive funding reforms.

Next Steps

We will keep you informed as additional guidance is made available. If we provide document services for your plan, we will let you know if any plan amendment is required. In the meantime, you may contact your plan's enrolled actuary for any plan funding questions.

Interest Rate Comparison Calendar Plan Years		
Purpose	Old Rate	New Rate
2004 Current Liability Calculation	5.51%	6.55%
DRC: 2001 Current Liability Calculation	6.21	7.44
2002 Current Liability Calculation	6.85	7.34
2003 Current Liability Calculation	6.65	7.11
2004 Quarterly Contribution Requirement (Prior Year Lookback)	5.82	7.11
PBGC Variable Rate Premium	4.31	4.94

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