GROOM LAW GROUP

COVID-19

A Review of the Single-Employer Funding Provisions Under the American Rescue Plan Act

ATTORNEYS & PROFESSIONALS

Mark Carolan
mcarolan@groom.com
202-861-5424

Michael Kreps
mkreps@groom.com
202-861-5415

Joshua Shapiro
jshapiro@groom.com
202-861-2613

PUBLISHED
04/12/2021

SOURCE
COVID-19 Resource

SERVICES

- Retirement Programs
- Fiduciary & Plan Governance
- Employer & Sponsor Advocacy

On March 11, 2021, President Biden signed into law the American Rescue Plan Act (Pub. Law 117-2, the "Act" or "ARPA"). The Act, among other things, provides significant funding relief for single-employer defined benefit pension plans, similar to the relief provisions in the HEROES Act (H.R. 6800, 116th Congress) passed by the House of Representatives in May 2020. This article focuses specifically on the Act's single-employer pension funding provisions. For more information on the other provisions of the Act, see our previous alert.

ARPA Funding Provisions

1. Extended Amortization

The Act provides that, starting in the 2022 plan year, the minimum funding requirements for single-employer pension plans will be calculated by amortizing future unfunded liability over 15 years (as opposed to the 7-year period that applied under prior law). Additionally, a plan's current unfunded liability will be reamortized (*i.e.*, the shortfall amortization bases will be reduced to zero) over a 15-year period—often referred to as a "fresh start". Although these provisions apply for plan years starting in 2022, plan sponsors may elect to apply these changes beginning with their 2019, 2020, or 2021 plan years. Note that this is a permanent change in the amortization period.

2. Interest Rate Relief

The Act extends—for a third time—and enhances the interest rate stabilization provisions that were first introduced in MAP-21 (in 2012), which would have started to be phased-out in 2021 under the prior law. This includes (1) providing an updated corridor for the 25-year average interest rate, which extends stabilization to 2030, and (2) setting a permanent 5-percent minimum for the 25-year average. These two relief provisions are generally effective for plan years beginning after December 31, 2019, but a plan sponsor may choose to disregard these two aspects of the funding relief for years prior to 2022 – either for all plan purposes or just for purposes of calculating the "AFTAP" to determine the applicability of the benefit restrictions under Internal Revenue Code section 436. The following table summarizes the stabilization corridor under prior law and under the Act. Note that a narrower corridor has a larger impact on the interest rate used to determine the plan liabilities, generally reducing minimum funding requirements for years prior to 2030.

	Old Corridor		**New Corridor**	
Year	Minimum	Maximum	Minimum	Maximum
2020	90%	110%	95%	105%
2021	85%	115%	95%	105%
2022	80%	120%	95%	105%
2023	75%	125%	95%	105%
2024	70%	130%	95%	105%
2025	70%	130%	95%	105%
2026	70%	130%	90%	110%
2027	70%	130%	85%	115%
2028	70%	130%	80%	120%
2029	70%	130%	75%	125%
2030+	70%	130%	70%	130%

To illustrate the impact of these changes, if the 25-year average of the 3rd segment rate for 2020 were to be 4%, then under prior law the lower boundary of this segment rate for minimum funding purposes would have been 90% of 4%, or 3.6%. Under the Act, however, a 5% floor applies to the 25-year average rate and the lower boundary is 95% of that rate, resulting in a rate of 4.75% for minimum funding purposes.

Ongoing Considerations for Plan Sponsors

The Act provides significant relief for sponsors of single-employer pension plans and is generally welcomed by the plan sponsor community. We note, however, that the funding relief does not change any of the following:

1. Calculation of PBGC premiums – A plan could become more underfunded on a premium basis if less contributions are being made to the plan under the Act, which would increase the variable-rate premium cost.

2. Calculation of the 4010 Funding Target Attainment Percentage – Under PBGC's regulations, for the purpose of determining whether annual ERISA 4010 filings are required, a plan's funded status is calculated without regard to interest rate stabilization.

3. Calculation of PBGC termination liabilities – If a plan terminates in an involuntary or distress termination, the underfunding is still calculated using the low interest rates prescribed by PBGC regulation, resulting in greater underfunding than calculated on an ongoing basis.

4. GAAP financial disclosures – A plan's funded status under GAAP is calculated using different assumptions than are used for funding, and generally yields higher liabilities shown on a sponsor's financial statements.

5. Cost to annuitize a plan – The cost to annuitize part or all of a plan is driven by the insurance markets, and is not related to the funding requirements under the Internal Revenue Code.

Need for Guidance

We note that technical guidance from the IRS regarding the application of retroactive elections of both the amortization and interest rate relief is sorely needed. Open issues for which guidance will be useful include:

1. The process and deadlines for making a retroactive election with respect to the extended amortization relief, or with respect to deferring the interest rate changes to 2022.

2. Whether a plan sponsor can disregard interest rate changes for all purposes or only for AFTAP/benefit restriction purposes for each of the 2020 and 2021 plan years, and/or make different elections for each year.

3. Whether an election to reduce a prior plan year's prefunding balance (in order to, for instance, avoid benefit restrictions) can be reversed if the Act's funding provisions render that election unnecessary.

4. Whether a prefunding balance can be waived retroactively if application of the Act's funding provisions make reduction of the prefunding balance necessary.

5. Whether prior year contributions can be added to a plan's prefunding balance if those contributions now exceed the required contributions, taking into account the funding relief under the Act.