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July 9, 2012 www.groom.com

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Pension Funding Relief and PBGC Premium Increases in Final Highway Legislation

On June 29, the House and Senate each passed a House-Senate Conference Agreement on federal highway and surface transportation legislation (H.R. 4348), and President Obama is expected to sign the legislation into law today. Notably, the final legislation – known as the "Moving Ahead for Progress in the 21st Century Act" – contains several important pension provisions as key revenue raisers, including pension funding relief that has been sought by the business community and increases in PBGC premiums that have been opposed by the business community. We summarize the pension-related changes in the final highway bill below.

Funding Relief Provisions

For the past six months or so, the business community has lobbied for targeted changes to the Pension Protection Act's (PPA's) minimum funding rules (and benefit restrictions) to adjust for periods of abnormally low or extremely high interest rates so as to remove the distortions caused by the current low interest rate environment. The final highway bill includes a rule that would adjust the relevant interest rates for any period to the extent that the rate for that period is not within a specified range of the average "segment" rates for the preceding 25-year period (ending September 30 of the calendar year before the calendar year in which the plan year begins). In particular, if a segment rate for an applicable month under the regular rules is less than the applicable minimum percentage, the segment rate is adjusted upward to match that percentage. If a segment rate for an applicable month under the regular rules is more than the applicable maximum percentage, the segment rate is adjusted downward to match that percentage. The following ranges would apply.

If the calendar year is	The applicable minimum percentage is	The applicable maximum percentage is
2012	90 percent	110 percent
2013	85 percent	115 percent
2014	80 percent	120 percent
2015	75 percent	125 percent
2016 or later	70 percent	130 percent

Certain additional information is required to be included in the annual funding notice of an applicable plan year, and the DOL is directed to modify the model funding notice to reflect this information.

These funding changes will not apply in a variety of related areas, including –

- the maximum interest rates used for calculating lump sum (and other non-annuity) payouts under Code section 417(e),
- the interest rate used for calculating maximum lump sum (and other non-annuity) payouts under Section 415(b),
- the limits on deductible employer contributions (sec. 404(a)),
- the calculations of variable rate PBGC premiums, and
- ERISA section 4010 reporting to PBGC.

The provision is generally effective for plan years beginning after December 31, 2011. An employer may, however, elect for any plan year beginning before January 1, 2013 not to have the new funding provision apply either (1) for all purposes for which the provision would otherwise apply, or (2) solely for purposes of determining the plan's adjusted funding target attainment percentage used in applying the funding-based benefit restrictions in Code section 436/ERISA section 206(g). The final legislation also provides that if, on the date of enactment, an employer election is in effect to use a monthly yield curve (rather than segment rates) to determine minimum required contributions, the employer may revoke the election and use segment rates as modified by the legislation, without obtaining IRS approval. Such a revocation must be made before the date that is one year after the date of enactment and the revocation would be effective for the first plan year to which the new rules apply and for all subsequent years.

PBGC Premium Increases

The final highway bill also includes nearly $9 billion in increases in PBGC premiums for single-employer plans, along with a more modest increase in multiemployer plan PBGC premiums. A different version of PBGC premium increases (including PBGC board discretion to adjust single-employer variable-rate premiums) was included in the Administration's budget proposals the past several years. In general, the bill includes the following changes.

- Flat-rate single-employer plan premiums will increase from $35 per participant to $42 per participant for 2013 and to $49 per participant for 2014. The $49 premium will be indexed to inflation after 2014.
- Variable-rate premiums, currently $9 per each $1,000 of unfunded vested benefits, will be indexed to inflation beginning in 2013, with an additional increase of $4 for 2014 and another $5 for 2015.
- The per-participant variable-rate premium will be subject to a cap, beginning at $400 for 2013, and indexed to inflation thereafter.
- Multiemployer plan flat-rate premiums will increase to $12 per participant for plan years beginning in 2013 and will be indexed to inflation thereafter.

The final agreement also imposes new governance requirements on the PBGC including:

- changes to the make-up of the PBGC's board of directors;
- mandatory independent review of PBGC's governance structure; and
- the addition of a Participant and Plan Sponsor Advocate.

Section 420 Changes

The bill would extend the current rules (Code section 420) that allow transfers of surplus pension assets to provide retiree health benefits through 2021. The provision also would extend (and generally apply, with modifications in certain areas such as the maintenance of cost rules) the section 420 rules to allow the use of surplus pension assets to provide up to $50,000 in group life insurance on eligible retirees.