

AT LONG LAST – A 30-YEAR TREASURY RATE REPLACEMENT

Congress approved H.R. 3108 – the Pension Funding Equity Act of 2004 – yesterday and President Bush has indicated that he will sign the measure into law. The bill provides funding and other relief to defined benefit plan sponsors for the 2004 and 2005 plan years. The IRS has indicated it will issue necessary guidance as soon as the President signs the bill.

The bill includes the following key provisions.

INTEREST RATE

The bill calls for interim replacement, for certain purposes, of the defunct 30-year Treasury bond rate with a composite rate based on conservatively invested long-term corporate bonds. The replacement rate will be effective for plan years beginning in 2004 and 2005 only. This change will result in a reduction, for many plan sponsors, of minimum funding requirements, required quarterly contributions and PBGC premiums.

The bill does not affect the interest rate used for certain other purposes, such as for calculating minimum lump sum distributions.

Minimum Funding Requirements. The bill redefines the permissible range of current liability interest rates used to calculate the deficit reduction contribution, one part of the minimum funding requirement. The plan may use any rate between 90% to 100% of a weighted four-year average of the rates of interest on long-term investment grade corporate bonds. Treasury is charged with determining the appropriate rates on the basis of two or more indices of corporate bonds that are in the top three quality levels available (e.g., Moody's Aaa, Aa and A).

For employers that seek to maximize deductions, the bill allows the use of existing rules to determine the maximum contribution.

Quarterly Contributions. The bill provides immediate and significant relief to employers who would otherwise have to make a quarterly contribution by April 15, 2004.

In general, each quarterly contribution for a plan year is 25% of the lesser of the minimum required contribution for the preceding plan year or 90% of the minimum required contribution for the current year. In the case of a calendar year plan, an employer will typically base its April 15 quarterly contribution on the previous year's minimum required contribution because the current year minimum has not yet been determined. If the bill had not passed, the 2003 minimum contribution would have had to be redetermined (for this purpose) using a lower interest rate than was actually used in 2003. The bill eliminates this recalculation

requirement, thus simplifying the process and reducing or eliminating the 2004 quarterly contribution requirement for many employers.

The bill also changes the interest rate to be used for the 90% alternative quarterly calculation for plan years beginning in 2004 and 2005 to the weighted average corporate bond rate (discussed under Minimum Funding Requirement above). This change could reduce quarterly contributions further.

In general, plans that are funded at 100% of current liability in 2003 are exempt from making quarterly contributions in 2004. The bill allows for the recalculation of the 2003 current liability, for this purpose, using the new corporate bond rates. The recalculation may eliminate the need to make 2004 quarterly contributions.

PBGC Variable Rate Premiums and 4010 Filings. The bill provides temporary relief with respect to the PBGC variable rate premium. Under the bill, the variable rate premium for plan years beginning in 2004 and 2005 is calculated using 85% of the new corporate bond rate, rather than 85% of the 30-year Treasury rate required prior to passage of the bill, for the month preceding the plan year.

Employers that have at least \$50 million in aggregate unfunded vested benefits in all their defined benefit plans have to file additional financial information with the PBGC under ERISA Section 4010. The actuarial assumptions to be used to calculate unfunded vested benefits are the same as those used in the calculation of PBGC variable rate premiums. For 4010 filings due April 15, 2004, the value of unfunded vested benefits can be determined using an interest rate that is either 85% of the new corporate bond rate or 100% of the 30-year Treasury rate, for the month of December 2003 in both cases. Note that the bill only changes the threshold test for determining if a filing is necessary, it doesn't change the information that has to be filed.

ADDITIONAL RELIEF FOR STEEL COMPANIES AND AIRLINES

The final bill also includes Deficit Reduction Contribution (DRC) relief, beyond the change in the current liability interest rate described above, for airlines, steel companies and the Transportation Communications Union plan. Eligible companies may elect, for 2004 and 2005 only, to determine the Additional Funding Requirement (AFR) as the greater of 20% of the regular AFR, or the full AFR calculated using a special DRC equal to the current liability normal cost. However, electing eligible employers must notify the PBGC and participants of the election. Further, electing eligible employers are limited in their ability to increase benefits by amendment.

MULTIEMPLOYER PLAN RELIEF

The bill provides limited funding relief to a small class of multiemployer plans – those which experienced an investment loss of at least 10% of assets in the plan year beginning in 2002 and for which the negotiated contributions are expected to be insufficient to satisfy minimum funding requirements in a plan year beginning after June 30, 2003 and before July 1, 2006. The relief defers funding of 80% of the 2002 actuarial loss. Certain other factors can make a plan ineligible for this relief, including a failure to pay excise taxes or if the employers didn't make more than minimal contributions in any plan year after 1993.

SENSE OF CONGRESS

In a Section entitled “Sense of Congress,” the bill indicates a need for a prompt and permanent replacement of the 30-year Treasury rate and comprehensive pension funding reform.

CONCLUSION

We are pleased that Congress was able to pass a bill providing for interim replacement of the 30-year Treasury bond interest rate. We now await Treasury guidance on the prescribed rates.

This NewsFlash is intended to provide general information. It does not offer legal advice or purport to treat all the issues surrounding any one topic. © 2004 Mellon Financial Corporation.