Single employer defined benefit pension plan relief enacted in the American Rescue Plan Act of 2021

The 117th Congress has passed, and the President has signed, relief for defined benefit (DB) pension plans offered by changes to the Internal Revenue Code in the American Rescue Plan Act of 2021 (ARP ‘21). These tax law changes affect single employer and multiemployer DB plans and have optional retroactive effective dates. A separate Milliman Multiemployer Review addresses the changes to multiemployer DB plan law.

Employers who sponsor single employer defined benefit plans may have found that the minimum required contributions under Internal Revenue Code (IRC) §430 to be paid in 2020 were too onerous to meet due to the catastrophic effects of the global pandemic on their businesses and their employees. In response, the Coronavirus Aid, Relief, and Economic Security (CARES) Act became law in March 2020 and permitted employers to delay these contributions until January 4, 2021. There were additional parts of the relief bill that were dropped from the CARES legislation in order to attend to other national priorities. Those dropped provisions are now part of the new law, the American Rescue Plan Act of 2021. These provisions, detailed below, provide additional flexibility to plan sponsors by permitting a longer time over which they can amortize the DB plans’ debt and by recasting the deficit using modified interest rates to calculate the actuarial liabilities.

Pension funding target reset and amortization period extended

ARP ‘21 sets all existing shortfall amortization bases to zero in the plan year in which the plan sponsor elects to apply the provisions of the new law. “Shortfall amortization base” is the term in pension law that refers to the amount of any deficit incurred in a plan year and in subsequent plan years, as measured in an annual actuarial valuation.

In essence, this is a refresh of the schedule to pay down (i.e., amortize) a DB plan’s funding deficit (funding liabilities in excess of the plan assets) on a chosen date permitted in ARP ‘21 (see next paragraph). In addition, the amortization period is extended to 15 years from seven years. In effect the plan sponsor’s relief is equivalent to more than doubling the time over which the pension deficit can be completely amortized.

Under ARP ‘21, a plan sponsor can choose this one-time refresh for the first plan year starting after December 31, 2018, or December 31, 2019, or December 31, 2020. If no election is made, the one-time refresh, by default, is effective for the first plan year starting after December 31, 2021. Afterwards, increases or decreases in subsequent plan years’ funding deficit must be quantified and amortized over 15 years.
Interest rate “stabilization” extended

The interest rates used to calculate actuarial liabilities and normal cost under IRC §430 are complex. Three interest rates are used (known as “segment rates”) and are based on a 24-month average of high-quality corporate bond yields. The three segment rates must then be set within a specified range around a 25-year average of corporate bond yields in order to determine a range of permissible interest rates to calculate the actuarial liabilities and normal costs for a given plan year. The range is determined by multiplying the 25-year average of each segment rate by a “minimum percentage” and a “maximum percentage” as applicable to each plan year.

ARP ’21 replaces the current table of minimum and maximum percentages (by calendar year) with a revised table containing new and higher percentages for all years 2020 through 2029. ARP ’21 further specifies that each of the three 25-year average rates to which the minimum and maximum percentages are applied is limited to be no less than 5%.

Both the new table of ranges and the 5% floor on 25-year average rates will result in three higher segment rates than under the pension law it is replacing. Therefore, the actuarial liabilities and normal costs will be lower than under the law it replaces. We choose not to predict future interest rates, but surmise that the 5% floor described above will be an important technical metric if interest rates are volatile. The complete table from ARP ’21 is included in the appendix of this Client Action Bulletin.

By default, the stabilization extension is effective for plan years beginning after December 31, 2019. A plan sponsor may alternatively choose to defer the effective date to plan years beginning after December 31, 2021.

Benefit restrictions based on extended interest rate stabilization

Benefit restrictions under IRC §436 in single employer DB plan funding rules mandate that if the ratio of plan assets to the actuarial liabilities falls below certain percentages, participants are prohibited from electing certain optional forms of pension benefits to which they are normally entitled. The most common form of payments that are restricted if the funded ratio is lower than 80% are lump sums. ARP ’21 provides that a plan sponsor uses the revised funded ratio resulting from application of interest rate stabilization to determine whether benefit restrictions apply. However, a plan sponsor can defer the application of the extended stabilization provisions for purposes of benefit restrictions to plan years beginning after December 31, 2021, even if they do not choose to defer the stabilization extension for minimum funding purposes to such plan year.

What this means for plan sponsors

Due to the ability to adopt the two changes independently, i.e., with different effective dates, and also due to the range of effective date choices, analysis and the decision process could become quite complex for plan sponsors. For most we expect there to be some advantage to adoption as early as possible, in terms of maximizing contribution flexibility, an advantage limited by the fact that the changes will not affect the actual long-term cost of the plan and offset by the cost of restating and refiling prior years that have already been completed. An analysis of the use of credit balances may be appropriate, as well as consideration of amended federal filings and participant communication.

As we write this, we acknowledge that it is imperative for the Internal Revenue Service (IRS) to issue technical guidance. There may also be a need for guidance from the Pension Benefit Guaranty Corporation (PBGC) as it did issue supplemental guidance when the CARES Act became law.

Accounting Standards Codification (ASC) Topic 960 and Topic 715 measurements are not affected, but any change in the plan sponsor’s funding pattern or funding policy will ultimately affect funded status being reported.

Milliman will be analyzing the consequences of options available to plan sponsors as rapidly as possible. Many questions have already become evident, and in time will only multiply. These changes are significant and far-reaching for pension funding rules. The long-term impact on plan funding health can only be speculated on at this time.

For more information on how this legislation may impact your single employer pension plan(s), please contact your Milliman consultant.
Appendix

ARP '21 inserts this table in IRC Section 430 as the applicable minimum and maximum percentages for a plan year beginning in a calendar year:

<table>
<thead>
<tr>
<th>If the calendar year is:</th>
<th>The applicable minimum percentage is:</th>
<th>The applicable maximum percentage is:</th>
</tr>
</thead>
<tbody>
<tr>
<td>Any year in the period starting in 2012 and ending in 2019</td>
<td>90%</td>
<td>110%</td>
</tr>
<tr>
<td>Any year in the period starting in 2020 and ending in 2025</td>
<td>95%</td>
<td>105%</td>
</tr>
<tr>
<td>2026</td>
<td>90%</td>
<td>110%</td>
</tr>
<tr>
<td>2027</td>
<td>85%</td>
<td>115%</td>
</tr>
<tr>
<td>2028</td>
<td>80%</td>
<td>120%</td>
</tr>
<tr>
<td>2029</td>
<td>75%</td>
<td>125%</td>
</tr>
<tr>
<td>After 2029</td>
<td>70%</td>
<td>130%</td>
</tr>
</tbody>
</table>

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