Pension Analyst
COMPLIANCE BULLETIN

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Pension Funding Equity Act of 2004 Provides Quarterly Contribution Relief for the 2004 Plan Year

On April 8, 2004, Congress passed the Pension Funding Equity Act of 2004 (PFEA). President Bush signed the bill into law on April 10, 2004. Among other provisions, the new law includes defined benefit plan quarterly contribution relief.

This *Compliance Bulletin* focuses only on this quarterly contribution relief and the new interest rate methodology that may be used in determining whether quarterly contributions are required for 2004.

Who's Affected?

The quarterly contribution relief affects all qualified single employer defined benefit plans that are subject to ERISA minimum funding rules. Governmental plans and nonelecting church plans are not subject to these rules. In addition, the quarterly contribution rules do not apply to multiemployer plans. This relief *only* applies to plan years beginning in 2004.

What is the New Interest Rate Methodology?

Plan funding is affected by the relationship of plan assets and liabilities. One of the measures of liability is "Current Liability," based on IRS-prescribed interest rates. Until now, that rate had been based on an average of 30-year Treasury bond rates. PFEA replaces the 30-year Treasury bond rate with a composite long term corporate bond rate for plan years beginning in 2004 and 2005. If Congress takes no further action, this interest rate will revert back to the 30-year Treasury bond rate starting with the 2006 plan year.

PFEA specifies how the new interest rate must be determined. On April 12, 2004, the Treasury made available to the public this new rate, the indices supporting the new rate, and the methodology used in determining the rate.

PFEA also defines a new a permissible range for interest rate selection for plan years 2004 and 2005. For these years, a plan may use an interest rate of no less than 90% and no more than 100% of the four-year weighted average of the composite long term corporate bond rate as determined by the Treasury.

As a result of this change in interest rate methodology, plans will be able to determine Current

Liability using a higher interest rate. For example, plans that have a calendar plan year will value Current Liability at 6.55%. If PFEA had not been enacted, the rate would have been 5.51%. This will reduce or eliminate accelerated contributions that would have otherwise been required for 2004 and 2005 plan years.

How are Quarterly Contributions determined for the 2004 Plan Year?

Single employer plans must make quarterly contributions if they fail to meet certain plan funding rules. For plans with calendar plan years, the first quarterly contribution for 2004 is due by April 15, 2004.

In determining whether quarterly contributions are due for a plan year, a plan must look back to the prior plan year's funded status (current liability vs. plan assets). 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.
Under old law, a plan would have had to recalculate its 2003 funded status and its 2003 required minimum contribution using a rate no higher than 105% of the four-year weighted average of the 30-year Treasury rate, just to determine if quarterly contributions were required for the 2004 plan year.

PFEA now permits a plan to rely on the 2003 plan year information in determining whether quarterly contributions are due in 2004, making recalculation unnecessary. It also allows plans to apply the new interest rate methodology to prior plan years, subject to guidance that will be provided by Treasury. As a result, quarterly contributions that otherwise would have been required may be entirely eliminated.

What Next?

Quarterly contribution relief is only one provision of the Pension Funding Equity Act of 2004. The new law also includes funding relief for some multiemployer plans, potential reduction of PBGC variable premium requirements, and other relief measures. We will be providing a separate communication addressing the other provisions of the Act in the near future.
If you have any questions about how PFEA affects your plan, please contact your plan's enrolled actuary.

On December 11, 2002, the IRS published proposed rules regarding ***age discrimination*** in qualified plans. The proposal is a follow-up to the IRS' 1988 proposed rules, which have never been finalized.

Like the 1988 rules, these new rules apply to ***all types*** of qualified defined benefit and defined contribution plans. In addition, they specifically address the application of these rules to cash balance plans. Most importantly, they convey the message that cash balance plans are not inherently age discriminatory.

The IRS has stated the new rules, as proposed, will be effective only for plan years beginning after the date they are adopted. In the meantime, plan sponsors may continue to rely on the 1988 age discrimination proposals.

General Age Discrimination Rules

A defined benefit plan is considered to be age discriminatory if a participant's rate of benefit accrual decreases or stops based solely on the participant's age. Likewise, a defined contribution plan is considered age discriminatory if the rate of allocation to a participant's account decreases or stops based solely on the participant's age.

This concept is not new. However, the new proposed rules now define "rate of accrual" and provide additional guidance through several examples. For defined benefit plans, two methods for determining rate of benefit accrual are provided: (1) the general rule, and (2) the rule for "eligible cash balance plans."

Proposed Special Rules for Cash Balance Plans

Certain cash balance plans may be treated like defined contribution plans for age discrimination testing. These plans are referred to as "eligible cash balance plans." Cash balance plans that are not "eligible cash balance plans" must use the general rule for age discrimination testing.

Outstanding Issues and Next Steps

Industry groups have identified a number of issues that are not addressed in these proposed rules. Some issues are:

- The "whipsaw" effect. Whipsaw occurs when the lump sum payment value of a participant's cash balance plan benefit exceeds the value of his hypothetical account balance.
- Application of the proposed rules to existing cash balance plans and other hybrid plans, such as pension equity plans.
- Application of the proposed rules to certain traditional defined benefit plan designs that were not previously considered age discriminatory, but now appear to be discriminatory.

Industry groups are currently preparing comments to be submitted to the IRS. Their initial reaction is that these proposed rules may provide only limited guidance for cash balance plans and potentially detrimental results for certain traditional defined benefit plan designs.

The IRS is accepting comments through March 13, 2003. They have scheduled a public hearing on April 9, 2003. If you have cash balance plan design issues that require immediate attention, you should contact the plan's enrolled actuary for assistance.