

## PENSION MANAGEMENT RESEARCH PANEL

## CFO Summary: The Financial Benefits of Recent IRS Pension Funding Relief (October 2009)

As many defined benefit plan sponsors continue to determine the long-term impact that the investment downturn of 2008 and early 2009 had on their defined benefit plans, some amount of funding relief has been delivered by the federal government. The Worker, Retiree, and Employer Recovery Act (WRERA) was signed into law in December 2008, providing modest funding relief for pension plan sponsors.

In March of this year, the Internal Revenue Service (IRS) issued guidance that addressed asset valuation methods for single employer defined benefit pension plans, provided automatic approval for a change in asset funding method for 2009 and also allowed for an automatic approval for a change in interest rate methods for 2009 (these methods usually cannot be changed more frequently than every fifth year). On September 25, 2009, the IRS released additional clarification permitting another automatic approval for an interest-rate method change in 2010, and more recently, final regulations applying to plan years beginning on or after January 1, 2010 were issued, incorporating this guidance.

### Relief Provided: Allowance to reselect liability rates for 2010

Up until the final regulations were issued, defined benefit plan sponsors were concerned whether the regulations would permit changes in the interest rates used to measure liabilities. This was of concern because the choices with respect to the interest rates that will be available for 2010 may influence the decisions that plan sponsors make for the 2009 plan year.

Under existing rules, plan sponsors may choose to use either a full yield curve (which is based on rates during a single month) or segment rates (which are based on an average during 24 months). In particular, many plan sponsors want to use the full yield curve for the 2009 plan year, but are concerned whether or not they would be permitted to change to the less volatile segment rates for the 2010 plan year. According to the final regulations, automatic approval for a new choice of interest rates is permitted for the first plan year beginning in 2010 (regardless of what choices were made for earlier plan years).

### Financial benefits of yield curve election for the 2009 calendar year will include:

- **Lower funding requirements for 2009**  
The ability to reselect liability rates should have big ramifications as the liability for calendar year plans will be 15 to 25 percent lower than if the smoothed rates were used for 2009. As a result of the decrease in liabilities and subsequent improved funding levels, financial executives should be able to expect lower overall contributions for 2009 than if the smoothed rates were used.
- **Fewer benefits will be limited**  
Under the current rules, if the liability for a plan falls below 80 percent (60 percent for additional restrictions) benefits may be limited on or before the tenth month of the year (October 1 for calendar year plans). Additional restrictions would be imposed if the liability for a plan falls below 60 percent. Use of the yield curve will increase the AFTAP funded ratio for 2009

calendar year plans, which should limit the amount of benefit restrictions imposed by these rules.

- **Lower PBGC premiums for 2009**

All single-employer pension plans pay a basic flat-rate annual premium of \$34 per participant. Underfunded single-employer plans pay an additional annual variable-rate charge of \$9 per \$1,000 of unfunded vested benefits. These premiums were due to the PBGC on October 15, 2009 for calendar year plans. The ability to reselect liability rates will result in significantly improved funded status for many calendar year plans, which should have served to lower the premium costs for the year.

- **Lower quarterly payments for 2010**

If a pension plan has a funding deficiency in the prior year, plan sponsors are required to make quarterly payments to the pension plan in the current year. Beginning on April 15, 2010, plan sponsors are required to make a payment of a quarter of the minimum required contribution for the previous year. The improvement in funded status for 2009 will lower required 2009 contributions, thus lowering the quarterly payments for 2010.

## Conclusion

This recent IRS guidance provides significant relief to plan sponsors and ends uncertainty around a critical component for pension plan funding for this year and next year. The relief provides plan sponsors with a significant amount of flexibility as it lessens the short-term cash requirements for the plan and gives plan sponsors the time to develop plan management strategies to deal with the losses that may have been incurred last year. Plan sponsors should continue to evaluate all aspects of the plan management moving forward, as this relief does not address the ongoing complexities and volatility that pensions continue to present to plan sponsors.

*For more information please email [seiresearch@seic.com](mailto:seiresearch@seic.com).*

*This information is for educational purposes only. Not intended to be investment, legal and/or tax advice. Please consult your financial/tax advisor for more information. Information provided by SEI Investments Management Corp., a wholly owned subsidiary of SEI Investments Company.*

©SEI 2009