INDUSTRY RESEARCH

# Wilshire Pension Funding Relief Update: American Rescue Plan Act of 2021

On March 11, 2021, President Joe Biden signed the American Rescue Plan Act of 2021 (ARPA-2021) which provides another round of funding relief since the passage of the Pension Protection Act of 2006 (PPA) to single employer corporate defined benefit pension plans. This short note will review the current and three previous rounds of funding relief.

When PPA went into effect for plan years beginning in 2008, corporate defined benefit plan sponsors were required to use high quality corporate bond yields (either a 24-month average segment rate curve or full corporate bond yield curve) to determine the liability value used to calculate plan sponsors' annual minimum required contribution amounts. The resulting discount rate from the use of high quality corporate bond yields was lower than the previous rate used to calculate liability values. This reduction in discount rate increased the liability value. Any funding shortfall amortization periods was reduced to seven years. The increased liability value and shortened period to amortize funding shortfalls served to increase annual minimum required contributions.

In 2012, the Moving Ahead for Progress in the 21st Century Act of 2012 (MAP-21) was passed. Due to the (then) historically low interest rates, plan sponsors were allowed to use a 25-year average of historic corporate bond yields within a 10% corridor expanding 5% annually thereafter until it reaches 30% in 2016 (see Exhibit 1 below) to determine the liability value used to calculate plan sponsors' annual minimum required contribution amounts. The change in the yields resulted in over a 100 basis point increase in the effective interest rate used to determine the liability value.

In 2014, the Highway and Transportation Funding Act of 2014 (HATFA-2014) extended the funding stabilization provisions under MAP-21 for an additional five years keeping the 10% corridor until 2017 (see Exhibit 1 below). This extension of the funding stabilization provisions allowed plan sponsors to use significantly higher than prevailing interest rates to determine the funding liability value used to establish minimum required contributions. Although these changes impacted the liability value, they did not have as significant of an impact as did the move to MAP-21.

In 2015, the Bipartisan Budget Act of 2015 (BBA-2015) further extended the corridor by an additional 3 years (see Exhibit 1 below) to determine the liability values used to calculate plan sponsors' annual minimum required contribution amounts. This extension of the funding stabilization provisions further allowed plan sponsors to use significantly higher than prevailing interest rates to determine the funding liability values used to determine minimum required contributions.

Most recently, ARPA-2021 makes two changes to the discount rate that determines the liability value used to calculate plan sponsors' annual minimum required contribution amounts:

1. Extends the shortfall amortization period from 7 to 15 years and
2. Allows plan sponsors a one-time election to reset all shortfall amortization bases in 2022 (or 2019, 2020 or 2021)

The two changes to the discount rate are:

1. A 5% floor placed on the 25-year average interest rate, and
2. The corridor is reduced to 5% until 2026 when it expands 5% annually until it reaches 30% in 2030.

  

Exhibit 1 shows the applicable corridors around the 25-year average segment rates starting with MAP-21. The cells highlighted in:

- Yellow indicates periods of corridor widening,
- Green indicates periods when corridor widening has been delayed, and
- Blue indicates periods when the corridor has shrunk

**Exhibit 1: Applicable Corridor Around 25-Year Average Segment Rates**

| | MAP-21 | | HATFA-2014 | | BBA-2015 | | ARPA-2021 | |
|---|---|---|---|---|---|---|---|---|
| YEAR | MIN | MAX | MIN | MAX | MIN | MAX | MIN | MAX |
| 2012 | 90% | 110% | 90% | 110% | 90% | 110% | 90% | 110% |
| 2013 | 85% | 115% | 90% | 110% | 90% | 110% | 90% | 110% |
| 2014 | 80% | 120% | 90% | 110% | 90% | 110% | 90% | 110% |
| 2015 | 75% | 125% | 90% | 110% | 90% | 110% | 90% | 110% |
| 2016 | 70% | 130% | 90% | 110% | 90% | 110% | 90% | 110% |
| 2017 | 70% | 130% | 90% | 110% | 90% | 110% | 90% | 110% |
| 2018 | 70% | 130% | 85% | 115% | 90% | 110% | 90% | 110% |
| 2019 | 70% | 130% | 80% | 120% | 90% | 110% | 90% | 110% |
| 2020 | 70% | 130% | 75% | 125% | 90% | 110% | 95% | 105% |
| 2021 | 70% | 130% | 70% | 130% | 85% | 115% | 95% | 105% |
| 2022 | 70% | 130% | 70% | 130% | 80% | 120% | 95% | 105% |
| 2023 | 70% | 130% | 70% | 130% | 75% | 125% | 95% | 105% |
| 2024 | 70% | 130% | 70% | 130% | 70% | 130% | 95% | 105% |
| 2025 | 70% | 130% | 70% | 130% | 70% | 130% | 95% | 105% |
| 2026 | 70% | 130% | 70% | 130% | 70% | 130% | 90% | 110% |
| 2027 | 70% | 130% | 70% | 130% | 70% | 130% | 85% | 115% |
| 2028 | 70% | 130% | 70% | 130% | 70% | 130% | 80% | 120% |
| 2029 | 70% | 130% | 70% | 130% | 70% | 130% | 75% | 125% |
| 2030 | 70% | 130% | 70% | 130% | 70% | 130% | 70% | 130% |

  

As Exhibit 1 shows (ARPA-2021 Column), the period over which the maximum corridor is reached has been delayed nearly 15 years. This will reduce the annual minimum required contribution amounts for plan sponsors.

Exhibit 2 shows an illustrative effective interest rate (EIR) forecast, a sample plan sponsor would use under various liability measurements beginning January 1, 2021.

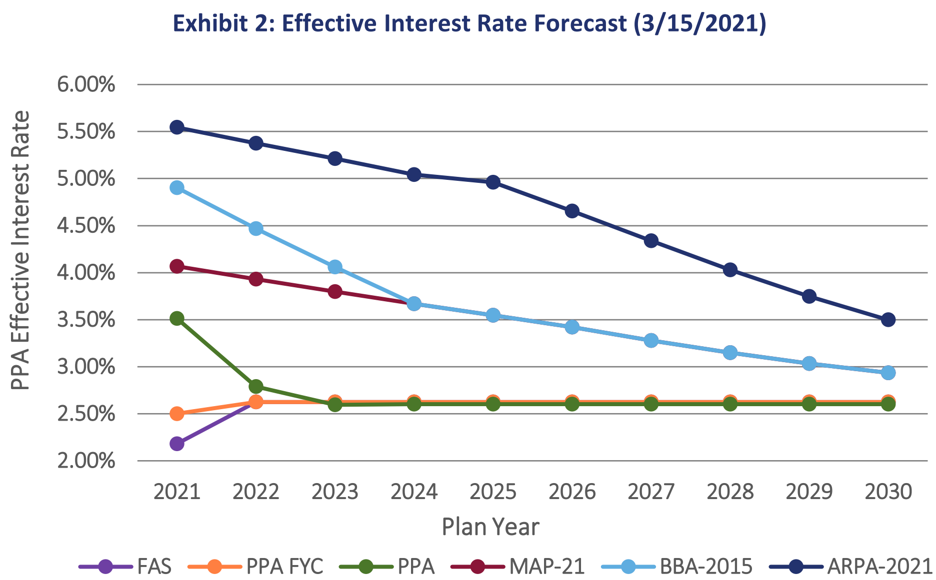


Exhibit 2 highlights the impact on the EIRs used to value pension liabilities for various metrics. Compared to the EIR under ARPA-2021:

- The EIR using the PPA 3-segment rates (PPA) and PPA Full Yield Curve (PPA FYC) are more than 200 basis points lower, and
- The EIR using the FTSE Pension Discount Curve (a proxy for EIR used for financial reporting - FAS) is almost 340 basis points lower

Assuming no changes to yields, the EIRs under ARPA-2021 are expected to remain elevated compared to prior funding stabilization provisions and will reach their floor of 3.50% in 2030.

Finally, the allowance for a one-time election to reset all amortization bases and the extension of the shortfall amortization period from 7 to 15 years further reduces projected minimum required contributions.

Using the same sample plan data as in Exhibit 2, Exhibit 3 below illustrates the initial shortfall amortization amount using the ARPA-2021 provisions as a proportion of the BBA-2015 initial shortfall amortization amount both assuming the plan sponsor elected to reset all shortfall amortization bases in the prior plan year.

**Exhibit 3: ARPA-2021 Shortfall Amortization Relative to BBA-2015**

| Funded Ratio | | Amort Ratio |
|---|---|---|
| BBA-2015 | ARPA-2021 | ARPA-2021 |
| 100% | 107% | 0% |
| 94% | 100% | 0% |
| 90% | 96% | 22% |
| 85% | 91% | 34% |
| 80% | 85% | 40% |

While the ARPA-2021 provisions may impact funding results for single employer corporate DB plan sponsors, it is important to keep in mind what it does not change: the reporting of pension plan liabilities and expense on corporate financial statements and how PBGC premiums (both flat and variable rate) are calculated.

The impact of the pension funding relief provided in the ARPA-2021 will differ across plans based on their circumstances. In aggregate, the minimum required contribution will be reduced for the foreseeable future. However, Wilshire anticipates that plan sponsors will continue to make discretionary contributions to reduce or eliminate PBGC variable rate premiums, to shift money from return-seeking and into liability hedging assets as their funded ratios improve and to adopt hibernation or end game strategies.

## Important Information



# More information

For more information, please contact us directly:

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