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Delaying Funding Stabilization's Phase-Out to Correspond to Interest Rate Projections

MAP-21, enacted in July 2012, provided critically needed stabilization of the current pension funding rules. However, this stabilization phases out well before the expiration of the problem it addressed – the Federal Reserve Board's low interest rates. In fact, recent reports indicate that the majority of Fed officials believe that interest rates will be maintained at low levels until sometime in 2015.

If interest rates continue to be maintained at low levels, 2017 is the earliest year that pension interest rates could return to normal. *Accordingly, Congress should delay the phase-out for at least four years, to start no earlier than* 2017, *instead of* 2013, *to fulfill Congress' original intent*.

PRE-MAP-21 LAW: Prior to MAP-21, pension funding obligations for a year were generally valued based on the average of corporate bond interest rates for the prior two years. Lower interest rates increase the valuation of funding obligations. As a result, the Fed's actions to keep interest rates artificially low caused pension funding obligations to be artificially inflated, diverting corporate assets away from jobs and business recovery.

MAP-21: MAP-21 very effectively addressed this problem in the short term. For 2012, MAP-21 required the applicable corporate bond interest rates to be within 10% of the 25-year average of corporate bond interest rates in order to eliminate the artificial effects of the Fed's actions. However, MAP-21 phased out the effective funding stabilization by increasing the 10% "corridor" to 15% in 2013, 20% in 2014, 25% in 2015, and 30% thereafter. This means that MAP-21 was materially less effective in 2013, is marginally effective in 2014, and has little effect for later years.

MISMATCH WITH FED'S POLICY: Starting in 2014, MAP-21 provides little funding stabilization. But since pension plan funding obligations are based on corporate bond interest rates for the prior two years, and the Fed plans to keep interest rates low into 2015, the interest rates used for valuing plan funding obligations will be artificially low through at least 2016. This mismatch needs to be addressed for the same reason that

MAP-21 was enacted: to prevent companies from diverting assets away from jobs and business investment.

RECENT REPORTS OF FUNDING IMPROVEMENTS: There have been several reports regarding how much funding levels have improved in the last year based on increases in interest rates – despite Fed actions – and on favorable market performance. There are two reasons why funding stabilization is still very much needed despite these reports. First, the funding levels reported are for accounting purposes; the accounting rules are based on spot interest rates. So any increase in interest rates causes funding levels to increase immediately for accounting; for funding, there is a significant lag before interest rate increases have an effect, so recent increases have had far less effect.

Second, many pension plans are heavily invested in the equity market, and benefited from the recent favorable market performance. However, the funding and accounting rules have caused many other plans to shift much more toward bonds in an effort to reduce asset value volatility. These plans not only missed out on the increases in the equity markets, but in many cases suffered losses in asset values attributable to bond holdings, due to rising interest rates. Thus, a significant number of plans have a great need for funding stabilization, and can hardly be blamed for reacting to the strong push of the current rules toward more conservative investments.

PROPOSAL: Delay the phase-out of funding stabilization for four years, so that the phase-out starts in 2017, instead of 2013. Because 2017 is the earliest year that pension interest rates could return to normal based on the Fed's plans, this matches Congressional intent with the Fed's announced policy.

The chart below summarizes the proposal:

	MAP-21:	PROPOSAL
	Interest rates used for pension funding must be:	Interest rates used for pension funding must be:
2012	Within 10% of 25-year average	Within 10% of 25-year average
2013	Within 15% of 25-year average	Same as 2012
2014	Within 20% of 25-year average	Same as 2012
2015	Within 25% of 25-year average	Same as 2012
2016	Within 30% of 25-year average	Same as 2012
2017	Same as 2016	Within 15% of 25-year average
2018	Same as 2016	Within 20% of 25-year average
2019	Same as 2016	Within 25% of 25-year average
2020 and later years	Same as 2016	Within 30% of 25-year average