25-Year Average Segment Rates and Adjusted 24-Month Average Segment Rates Used for Pension Funding

Notice 2012-55

This notice provides guidance on the 25-year average segment rates that are applied to adjust the otherwise applicable 24-month average segment rates that are used to compute the funding target and other items under § 430 of the Internal Revenue Code (Code) and § 303 of the Employee Retirement Income Security Act of 1974 (ERISA). The guidance reflects the changes made to the Code and ERISA by the Moving Ahead for Progress in the 21st Century Act (MAP-21), Pub. L. No.112-141, which was enacted July 6, 2012.

BACKGROUND

Section 430 specifies the minimum funding requirements that generally apply to single-employer defined benefit pension plans pursuant to § 412. Section 430(h)(2) specifies interest rates that are used for purposes of calculating the minimum required contribution. The interest rates that are used for this purpose are a set of three segment rates described in § 430(h)(2)(C)(i), (ii), and (iii), or, alternatively, a full yield curve as described in § 430(h)(2)(D)(ii).

Each segment rate described in § 430(h)(2)(C)(i), (ii), and (iii) is, for any month, the single rate of interest determined by the Secretary for the month on the basis of the applicable corporate bond yield curve for that month, taking into account only that portion of the yield curve applicable to that segment. Section 430(h)(2)(D)(i) provides that the Secretary shall prescribe a corporate bond yield curve applicable for each month. The applicable corporate bond yield curve is, with respect to any month, a yield curve which reflects a 24-month average (the average of the yield curve values for the preceding month and the prior 23 months) of the yields on investment grade corporate bonds with varying maturities that are in the top 3 quality levels available. Under § 430(h)(2)(D)(ii), an employer may elect to use the corporate bond yield curve determined without regard to the 24-month averaging, in lieu of the segment rates.

Section 40211(a) of MAP-21 adds § 430(h)(2)(C)(iv), generally effective for plan years beginning on or after January 1, 2012. Section 430(h)(2)(C)(iv) provides that, for a plan year, each of the three segment rates described in § 430(h)(2)(C)(i), (ii), and (iii) is adjusted as necessary to fall within a specified range that is determined based on a percentage of the average of the corresponding segment rates for the 25-year period ending on September 30 preceding the calendar year that includes the first day of that plan year. Under § 430(h)(2)(C)(iv)(II), for plan years beginning in 2012, each segment rate is adjusted so that it is no less than 90% and no more than 110% of the corresponding 25-year average segment rate. For later plan years, this range is gradually increased, so that the segment rates for plan years beginning after 2015 are no less than 70% and no more than 130% of the corresponding 25-year average segment rates.

Section 430(h)(2)(C)(iv)(I) provides that the Secretary may prescribe equivalent rates for any years in the 25-year period for which segment rates are not available.

Section 430(h)(2)(F) (as amended by MAP-21) provides that each month the Secretary shall publish the corporate bond yield curve, the segment rates in § 430(h)(2)(C), and the 25-year average of the segment rates. Section 430(h)(2)(F) also provides that the Secretary shall publish a description of the methodology used to determine the yield curve and the segment rates in sufficient detail to enable plans to make reasonable predictions regarding the yield curve and rates for future months. Notice 2007–81, 2007–2 C.B. 899, provides guidelines for determining the monthly corporate bond yield curve and the 24-month average corporate bond segment rates.

DEVELOPMENT OF EQUIVALENT RATES

Segment rates determined under § 430(h)(2)(C) (i), (ii) and (iii) are available as far back as October 2005. The October 2005 segment rates are the average of the "spot" segment rates for the 24 months beginning October 2003 and ending September 2005. In order to determine equivalent rates for earlier months, the Treasury Department used a statistical regression analysis to combine information about the relationship of the spot segment rates, zero-coupon yields for Treasury securities ("Treasury spot rates"), corporate bond index values, and Constant Maturity Treasury rates – using monthly average rates for the period October 2003 through July 2011 – in order to estimate spot segment rates for months back to October 1984.

Specifically, the spot segment rates for months before October 2003 were estimated using regressions that compared, for the period October 2003 through July 2011, the spreads between the spot segment rates and a corresponding average of Treasury spot rates with spreads between two corporate bond indices and Constant Maturity Treasury rates ("corporate bond spreads"). For the first segment regression, the corresponding average of Treasury spot rates was the average over the period of 1-5 years and the two corporate bond spreads were the difference between a Citigroup A bond index and the 7- year Constant Maturity Treasury rate and the difference between a Citigroup AA-AAA bond index and the 7-year Constant Maturity Treasury rate. For the second segment regression, the corresponding average of Treasury spot rates was the average of the Treasury spot rates for the period of 6-20 years and the corporate bond spreads were the same as those that were used in the first segment regression. For the third segment regression, the corresponding average of Treasury spot rates was the average of the Treasury spot rates for the period of 21-60 years, assuming that the spot rates for years after 30 was the same as for year 30, and the corporate bond spreads were the same as those that were used in the first and second segment regressions.

The result of the regressions was a series of coefficients that were applied to the corporate bond spreads for months before October 2003 in order to estimate a spread that can be added to the corresponding average of Treasury spot rates for those months in order to estimate monthly spot segment rates for each month before October 2003. The estimated monthly spot segment rates were combined with the actual monthly spot segment rates for October 2003 and later months in order to determine rates that are equivalent to the segment rates for months before October 2005.

DETERMINATION OF THE 25-YEAR AVERAGE OF SEGMENT RATES

Based on the calculation of equivalent rates for months before October 2005 and actual segment rates for later months, the averages, for the 25 years ending September 30, 2011, of the first, second, and third segment rates are 6.15, 7.61, and 8.35 percent, respectively.

ADJUSTED 24-MONTH AVERAGE SEGMENT RATES

In prior notices, the Treasury and the Service issued 24-month average segment rates that did not reflect the adjustment required by § 430(h)(2)(C)(iv) (as added by MAP-21). Table 1 contains previously issued 24-month average segment rates without adjustment, and, for plan years beginning in 2012, the adjusted 24-month average segment rates taking into account the 90-110% corridor around the 25-year average segment rates:

Table 1: Adjusted 24-Month Average Segment Rates

Applicable		24-Month Average Segment Rates not Adjusted			Adjusted 24-Month Average Segment Rates, For Plan Years Beginning in 2012, Using 25-Year Average Segment Rate Corridors		
Year	Month	First Segment	Second Segment	Third Segment	First Segment	Second Segment	Third Segment
2011	September	2.06	5.25	6.32	5.54	6.85	7.52
2011	October	2.03	5.20	6.30	5.54	6.85	7.52
2011	November	2.01	5.16	6.28	5.54	6.85	7.52
2011	December	1.99	5.12	6.24	5.54	6.85	7.52
2012	January	1.98	5.07	6.19	5.54	6.85	7.52
2012	February	1.96	5.01	6.13	5.54	6.85	7.52
2012	March	1.93	4.95	6.07	5.54	6.85	7.52
2012	April	1.90	4.90	6.01	5.54	6.85	7.52
2012	May	1.87	4.84	5.96	5.54	6.85	7.52
2012	June	1.84	4.79	5.90	5.54	6.85	7.52
2012	July	1.81	4.73	5.85	5.54	6.85	7.52
2012	August	1.77	4.67	5.78	5.54	6.85	7.52

POSSIBLE CHANGE IN METHODOLOGY FOR FUTURE YEARS AND FUTURE GUIDANCE ON OTHER ISSUES

The methodology described in this Notice that was used for determining equivalent rates for months prior to October 2005 reflects a balance between the goal of a timely determination and publication of the 25-year average segment rates and the goal of having the equivalent rates be as close as possible to the segment rates that would result from application of the method currently used to determine the monthly corporate bond yield curve and the related spot segment rates. The Treasury Department is considering replacing the methodology for determining the equivalent rates for months before October 2005, including possibly by applying the method -- based on bond price data -- that is currently used to determine the monthly corporate bond yield curve and the related spot segment rates. In no event would any such change in the methodology apply for purposes of plan years beginning in 2012.

The Treasury and the Service intend to issue additional guidance in the near future on other issues relating to the application of the MAP-21 amendments, including guidance relating to benefit restrictions and transition issues.

DRAFTING INFORMATION

The principal author of this notice is Tony Montanaro of the Employee Plans, Tax Exempt and Government Entities Division. However, other personnel from the Service and the Treasury Department participated in preparing this notice. Mr. Montanaro may be e-mailed at *RetirementPlanQuestions@irs.gov.*