CHARTWELL VIEWS

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Bipartisan Budget Act of 2015

On November 2, 2015, the Bipartisan Budget Act of 2015 ("BBA 2015") was signed into law. This legislation includes three provisions that impact single-employer defined benefit pension plans:

1. Congress further extended defined benefit pension plan funding stabilization provisions originally included in the MAP-21 Act in 2012 and extended in HATFA in 2014.

2. The act increases PBGC flat-rate and variable-rate premiums for pension plan sponsors. It also accelerates premium due dates for plan year 2025.

3. BBA 2015 allows plan sponsors to apply to Treasury to use custom mortality tables based on plan experience for the purposes of determining funding, PBCG premiums, and benefit restrictions.

BBA 2015 effects plan years beginning in 2017.

1. Pension Funding Relief: Extension of MAP-21

Under BBA 2015, plan sponsors of single employer defined benefit plans may continue to measure pension liability using the 25-year average of segment rates plus or minus a 10% corridor (i.e., the MAP-21 rates) through 2020, with a 5% increase applying to each year thereafter through 2023. The corridor will remain at 30% after 2023. Prior to enactment of the BBA, the 10% corridor was scheduled to increase by 5% each year beginning after 2017 through 2020, and would have remained at 30% after 2020.

With interest rates at historical lows, BBA 2015 impacts minimum contributions required by plan sponsors. It extends provisions of MAP-21 and HATFA that prescribe artificially high interest rates, higher funding measures, and therefore, lower minimum required contributions.

Limiting the effective interest rate segments based on 25-year averages tends to increase the overall Effective Interest Rate, and therefore lowers the calculation of minimum funding requirements.

BOTTOM LINE: This extension means that plan sponsors will have more flexibility in determining how much they contribute for an additional three years. The provision is "budget friendly" because if pension plan sponsors do contribute less to pension plans, they will receive a smaller tax deduction, resulting in increased tax revenues that offset other costs included in BBA 2015. Of course, plan sponsors may not choose to take advantage of this extension in flexilbility. And, this contribution flexibility will need to be weighed by plan sponsors against the PBGC premium cost increases.

If the 2-year average discount rate is below the 25-yr average, the following percentages are applied to the 25-year average discount rate

Plan Years Beginning in	MAP-21 2012 Minimum[2]	HATFA 2014 Minimum[3]	BBA 2015 Minimum[4]
2012	90%	90%	90%
2013	85%	90%	90%
2014	80%	90%	90%
2015	75%	90%	90%
2016	70%	90%	90%
2017	70%	90%	90%
2018	70%	85%	90%
2019	70%	80%	90%
2020	70%	75%	85%
2021	70%	70%	80%
2022	70%	70%	75%
2023	70%	70%	70%

2. Increased PBGC Premiums

The PBGC was created to ensure the continued payment of some pension benefits to defined benefit penson participants in the event of plan sponsor bankruptcy or other PBGC takeover of the plan. It is primarily funded by the premiums assessed on the pension plans it covers. These premiums include two components: a flat-rate premium based on the number of plan participants, and a variable-rate premium based on the level of the plan's unfunded vested benefits (UVB).

BBA 2015's PBGC premium provisions significantly increase the flat and variable premium rates for single-employer defined benefit plans. These increases go above and beyond those enacted in MAP-21 and the BBA 2013.

The details of these premiums are shown in the table below. Increases highlighted for plan years 2017 through 2019 are associated with BA 2015.

PBGC Premium Schedules for Single Employer Plans[5,6]		
Plan Years Beginning in	Per Participant Flat Rate	Variable Rate
		Rate per $1,000 unfunded
2007	$31	$9
2008	$33	$9
2009	$34	$9
2010	$35	$9
2011	$35	$9
2012	$35	$9
2013	$42	$9
2014	$49	$14
2015	$57	$24
2016	$64	$30
2017	$69	$33
2018	$74	$37
2019	$80	$41

In addition to increases in the above fixed and variable PBGC premiums rates legislated under BBA 2015, the rates are indexed to increases in the national average wage rate. Assuming 3% annual increase in future national average wages, we project the variable premium rate will reach 4.4% of unfunded liabilities in 2019.

Finally, BBA 2015 did not change the current per-participant cap on the variable-rate premium. As a result, the premium increases will have the biggest impact on plans that are underfunded, but not so underfunded that they are subject to the cap.

BOTTOM LINE: By 2019, PBGC's flat-rate and variable-rate premiums will have increased by more than 150 percent and 340 percent, respectively, since 2007. While extension of MAP-21 rules through 2019 provides plan sponsors with the flexibility to defer annual fundings, the rapidly increasing cost of being underfunded, in terms of PBGC premiums, provides an incentive to make contributions in excess of the minimum required amount.

3. Custom Mortality Tables

Pension actuaries utilize mortality tables prescribed by the Treasury Department to determine how long participants will live and collect benefits for funding purposes. In 2014, the Society of Actuaries released two new tables that dramatically increased how much plan sponsors owed participants in present value terms. The Treasury is widely anticipated to adopt similar tables in 2017.

BBA 2015 will allow plan sponsors to apply to the Treasury to utilize tables based on plan-specific experience, as opposed to Treasury-prescribed tables, thus allowing more flexibility.

Under prior pension funding rules, a specific minimum amount of experience data was needed in order to reflect actual plan longevity experience in pension funding valuations. If the threshold was not met, plans were required to use the IRS standard mortality tables. BBA 2015 allows for the development of plan-specific mortality tables based on a credibility weighting of actual experience.

BOTTOM LINE. Plan sponsors will have more flexibility, subject to Treasury approval, in determining mortality tables used for funding purposes. We don't expect this provision to be of much use to smaller plans, because the "credible information determination" standard is based heavily on the number of observations.

EXECUTIVE SUMMARY

BBA 2015 will prompt many pension plan sponsors to reconsider several aspects of their plan management strategies:

Settlement strategy. Settling plan liabilities through lump-sum windows, small amount cash-outs, lump-sum optional payments, and annuity buyouts becomes more desirable to reduce participant headcounts - particularly for plans impacted by the per-participant maximum.

Funding strategy. Plan sponsors may want to consider discretionary contributions to improve funded status. Carrying costs on unfunded liabilities are set to rise from just over 3.3% in 2017, to nearly 4.4% in 2019, and rise from there. This can be saved through avoidance of PBGC variable-rate premiums. And, the value of this savings componds over time, since the costs are avoided each year the plan would have otherwise remained underfunded. Assuming reasonable ROA, the overall implied returns on accelerated contributions may be compelling, especially for those plans that can readily borrow the contributions (exchanging soft debt for hard).

Investment strategy. Dynamic investment policies that reduce investment risk as plan funded status improves will become more attractive due to the increased penalty (higher variable premiums) for plan underfunding. The added cost of risky investment strategies in downside scenarios will make the risk-reward trade-off favor less risky investments for well-funded plans. At the same time, decreased interest rate sensitivity in plan funding requirements may have the opposite effect (i.e., lower allocations to liability-hedging investments). We expect the net effect will be an increased appetite for LDI strategies but a steepening of associated glidepaths.

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