



The ERISA Industry Committee

Advocating the Employee Benefit & Compensation Interests of America's Largest Employers*

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PLAIN ENGLISH EXPLANATION OF THE ERISA FUNDING RULES

To ensure that a defined benefit pension plan has sufficient assets to pay benefits when participants retire, ERISA and the Internal Revenue Code require the plan's sponsor to make minimum contributions to the pension plan. These minimum required contributions are calculated using reasonable assumptions and are equal to the normal cost of the plan plus amounts necessary to amortize over specified periods unfunded past service liabilities, experience gains or losses, waived funding deficiencies, changes in actuarial assumptions, and certain other items. Most defined benefit plans are funded under these original ERISA rules, as modified over time.

A plan that is considered either significantly or persistently underfunded will be subject to an additional set of funding rules. Basically, these rules look at whether a plan is likely to be able to buy annuities to cover its current level of accrued benefit promises in the future. If a plan is far from being able to buy annuities, the rules require that additional cash be put into the plan, accelerating the pace of pension funding. These rules, commonly called the "current liability" funding rules, were added to the law in 1987 and modified in 1994, and are the focus of our discussion today.

The current liability funding rules require the sponsor to use a specified mortality table and to calculate liabilities using an interest rate that is within a range of rates based upon the four-year weighted average of 30-year Treasury bonds. As amended in 1994, the permissible range is no lower than 90% of the 30-year bond average and no higher than 105% of the 30-year bond average. For 2002 and 2003 only, a plan may use a rate of up to 120% of the 30-year bond average. Congress enacted this short term-higher range last March (P.L. 107-147) in recognition of the fact that, as a result of the rise of budget surpluses followed by the decision of the Treasury to cease issuing 30-year bonds, the 30-year bond rate had dropped to levels that produced highly inaccurate and inflated calculations of pension liability.

The current liability rules come into play if, using these mandated assumptions, a plan is either considered significantly or persistently underfunded -- that is, if plan assets are less than 80% of current liabilities or if plan assets are less than 90% of current liabilities for two of the last three years. Plans with any unfunded current liabilities must also make contributions on a quarterly basis during the plan year instead of making one annual contribution after the end of the plan year.

Current liability is also calculated to determine whether a plan sponsor will pay a \$19 per participant flat rate premium tax to the Pension Benefit Guaranty Corporation, or whether the sponsor must, in addition, pay a variable rate premium tax based on the plan's unfunded vested benefit liability.

The 30-year Treasury rate is also used (without averaging and without the corridor available for funding purposes) to calculate the minimum lump sum that may be paid to a plan participant.