

# Weighted Average Interest Rate Modification

## Notice 2004-34

This notice provides guidance as to the determination of the weighted average interest rate and the resulting permissible range of interest rates used to calculate current liability for the purpose of the additional funding requirements under § 412(l) of the Internal Revenue Code and the minimum full funding limitation of § 412(c)(7)(E) of the Code, the corresponding requirements and limitation under §§ 302(c)(7)(E) and 302(d) of the Employee Retirement Income Security Act of 1974 (ERISA). In addition, this notice sets forth the interest rate under § 4006(a)(3)(E)(iii)(V) of ERISA, which is needed in the determination of unfunded vested benefits for purposes of determining premiums payable to the Pension Benefit Guaranty Corporation (PBGC). This notice implements changes to the rules regarding those interest rates that were enacted in section 101 of the Pension Funding Equity Act of 2004, P.L. 108-218.

### BACKGROUND AND PRIOR LAW

Under § 412(b)(5)(A) of the Code, the funding standard account (and items therein) must be charged or credited with interest at the appropriate rate consistent with the rate or rates of interest used under the plan to determine costs.

Section 412(b)(5)(B) provides special rules for the interest rate that is used to determine a plan's current liability for purposes of § 412(l) and for purposes of the minimum full funding limitation under § 412(c)(7)(E). In general, that interest rate must fall within a specified corridor based on the weighted average of the rates of interest on 30-year Treasury constant maturities during the 4-year period ending on the last day before the beginning of the plan year, as published monthly in the Internal Revenue Bulletin. See Notice 88-73, 1988-2 C.B. 383. Under Notice 2002-26, 2002-1 C.B. 743, the interest rate used in determining the weighted average interest rate currently is based on the yield on the 30-year Treasury bonds maturing in February 2031.

In general, § 412(l)(7)(C)(i)(II) specifies that, for years after 1998, the interest

rate used to determine the deficit reduction contribution must be not more than 105% of the weighted average interest rate. A special rule for 2002 and 2003 was enacted in the Job Creation and Worker Assistance Act of 2002 (Pub. L. No. 107-147, 116 Stat. 21) to provide for the deficit reduction contribution under § 412(l) to be calculated using a corridor capped at 120% of the weighted average interest rate rather than 105% of the weighted average interest rate.

### PENSION FUNDING EQUITY ACT OF 2004

The Pension Funding Equity Act was enacted on April 10, 2004. Section 412(b)(5)(B)(ii)(II) of the Code, which was added by section 101 of the Pension Funding Equity Act, provides that, for plan years beginning in 2004 and 2005, the interest rate used to determine current liability must not be above and must not be more than 10 percent below the weighted average of the rates of interest on amounts invested conservatively in long-term investment-grade corporate bonds during the 4-year period ending on the last day before the beginning of the plan year. Under § 412(b)(5)(B)(ii)(II), the Treasury Department must prescribe a method for periodically determining the rates. These rates must be based on the use of two or more indices that are in the top three quality levels available. The Treasury Department must make the permissible range, and the indices and methodology used to determine the average rate, publicly available.

Section 412(l)(7)(C)(i)(IV), which was also added by the Pension Funding Equity Act, provides that, for plan years beginning in 2004 and 2005, the interest rate used to determine current liability for purposes of determining the deficit reduction contribution must be the same as the rate used under § 412(b)(5).

### INTERIM GUIDANCE

This notice provides interim guidance on the determination of the weighted average interest rate under § 412(b)(5)(B)(ii)(II) of the Code and § 302(b)(5)(B)(ii)(II) of ERISA. In addition, this notice provides interim guidance as to the interest rate under § 4006(a)(3)(E)(iii)(V) of ERISA, which

is needed in the determination of unfunded vested benefits for purposes of determining premiums payable to the PBGC. Taxpayers can rely on this interim guidance until the publication of further guidance. Any further guidance will not apply to plan years beginning before the publication of further guidance. The determination of the weighted average involves: a specification of the indices; the determination of the rate of interest on amounts invested conservatively in investment-grade corporate bonds (the “composite corporate bond rate”); and the determination of a 4-year weighted moving average of the composite corporate bond rate (the “corporate weighted average interest rate”).

### *Specification of Indices*

The following indices are designated for use in determining composite corporate bond rates beginning with January 1997 and ending August 2000.

1. Citigroup High Grade Corporate Index (AAA/AA, 10+ Years)
2. Merrill Lynch US Corporates AA-AAA Rated 10+ Years
3. Merrill Lynch US Corporates A Rated 15+ Years

The following indices are designated for use in determining the composite corporate bond rates beginning with September 2000 and continuing until further guidance is issued:

1. Citigroup High Grade Credit Index<sup>1</sup> (AAA/AA, 10+ Years)
2. Merrill Lynch US Corporates AA-AAA Rated 10+ Years
3. Lehman Brothers US A Long Credit

All of these indices reflect interest rates on long-term corporate bonds that are in the top three quality levels.

### *Composite Corporate Bond Rate*

The composite corporate bond rate for a month is determined using the indices designated in this notice. For each index designated for inclusion in determining the composite corporate bond rate for a month, a monthly rate is determined based on the average of the daily values for the yield to maturity for the bonds that are included in the index, as determined by the financial service firm maintaining the in-

dex. The composite corporate bond rate for the month is determined by computing the average of these monthly rates. Table 1 lists the composite corporate bond rates for the months January 2000 through March 2004.

### *Corporate Weighted Average Interest Rate and Section 412(b)(5)(B)(ii)(II) Permissible Range*

The corporate weighted average interest rate under § 412(b)(5)(B)(ii)(II) for a month is determined by applying the weighting methodology set forth in Notice 88-73 to the composite corporate bond rates for the 48 months preceding that month. Thus, in determining the 48-month weighted average of the composite corporate bond rate, the composite corporate bond rate for each of the months within the immediately preceding 12 months receives a weight of 4, those that are 13–24 months in the past receive a weight of 3, those that are 25–36 months in the past receive a weight of 2 and those that are 37 or more months before the determination receive a weight of 1. The § 412(b)(5)(B)(ii)(II) permissible range is 90% to 100% of the corporate weighted average interest rate. Table 2 lists the corporate weighted average interest rates and the permissible range for plan years beginning in the months January 2001 through April 2004.

### *Lookback Rules*

Under section 101(d)(2) of the Pension Funding Equity Act of 2004, for purposes of applying section 412(l)(9)(B)(ii) and section 412(m)(1) of the Code (and section 302(d)(9)(B)(ii) and section 302(m)(1) of ERISA) to plan years beginning after December 31, 2003, the amendments made by section 101 of the Pension Funding Equity Act of 2004 may be applied as if such amendments have been in effect for all prior years. Thus, for example, for the plan year beginning January 1, 2004, in determining whether the plan’s funded current liability percentage was at least 90 percent for two consecutive years of the previous three years under section 412(l)(9)(B)(ii), the funded current liability percentage may be recalculated using the corporate weighted average interest

rate applicable for plan years beginning in January 2001, 2002, and 2003. Similarly, in determining whether a plan is subject to quarterly contributions under section 412(m)(1) for the plan year beginning January 1, 2004, the funded current liability percentage for 2003 may be recalculated using the corporate weighted average interest rate.

However, for purposes of computing the required installment under section 412(m)(4) for plan years beginning in 2004, the required amount for plan years beginning in 2003 may not be recalculated using the corporate weighted average interest rate. Instead, the required amount for 2003 will continue to be determined based upon an interest rate which is within the range of 90 to 120 percent of the weighted average of the rate of interest on 30-year Treasury securities.

### *Monthly Publication of Rates*

The IRS will publish by notice each month the composite corporate bond rate, the corporate weighted average interest rate, and the § 412(b)(5)(B)(ii)(II) permissible range. The same notice will specify a change in the group of indices that are taken into account in determining the component corporate bond rate, and the manner they are taken into account, if any such change takes place.

### *Request for Comments*

Comments are requested regarding the determination of the composite corporate bond rate set forth in this notice. Specifically, comments are requested regarding the appropriateness of the indices that are used in the determination of this rate, whether other indices would be more appropriate for this purpose, and the appropriateness of the weight given to each index.

Comments should be submitted by August 2, 2004, to CC:PA:LPD:RU (Notice 2004-34), Room 5203, Internal Revenue Service, POB 7604, Ben Franklin Station, Washington, D.C. 20044. Comments may be hand delivered between the hours of 8 a.m. and 5 p.m., Monday through Friday to CC:PA:LPD:RU (Notice 2004-34), Courier’s Desk, Internal Revenue Service, 1111 Constitution

<sup>1</sup> The name of the Citigroup High Grade Corporate Index was changed to the Citigroup High Grade Credit Index in April 2001, when a new Citigroup High Grade Corporate Index was created.

Ave., NW, Washington D.C. Alternatively, comments may be submitted electronically via e-mail to the following address: *Notice.Comments@irs.counsel.treas.gov*, with "Notice 2004-34" in the subject line. All comments will be available for public inspection.

*Drafting Information*

The principal author of this notice is Tony Montanaro of the Employee Plans, Tax Exempt and Government Entities Division. For further information regarding this notice, please contact the Employee Plans' taxpayer assistance telephone ser-

vice at 1-877-829-5500 (a toll-free number), between the hours of 8:00 a.m. and 6:30 p.m. Eastern time, Monday through Friday. Mr. Montanaro may be reached at 1-202-283-9714 (not a toll-free number).

**Table 1**  
**Composite Corporate Bond Rates**

Month	Composite Rates for:				
	2000	2001	2002	2003	2004
January	7.94	7.34	6.92	6.07	5.68
February	7.84	7.21	6.86	5.90	5.63
March	7.87	7.08	7.10	5.89	5.44
April	7.84	7.28	7.03	5.91	
May	8.27	7.28	6.99	5.42	
June	8.05	7.17	6.76	5.24	
July	7.93	7.13	6.74	5.77	
August	7.82	6.95	6.57	6.19	
September	7.87	7.05	6.27	5.95	
October	7.85	6.91	6.47	5.91	
November	7.82	6.82	6.30	5.86	
December	7.51	7.07	6.18	5.81	

**Table 2**  
**Corporate Bond Weighted Average Interest Rates**

For Plan Years Beginning in:	Year	Month	Corporate Bond Weighted Average	Permissible Range	
				90%	100%
2001	January	7.44	6.69	7.44	
2001	February	7.44	6.69	7.44	
2001	March	7.44	6.69	7.44	
2001	April	7.43	6.68	7.43	
2001	May	7.42	6.68	7.42	
2001	June	7.42	6.68	7.42	
2001	July	7.41	6.67	7.41	
2001	August	7.40	6.66	7.40	
2001	September	7.39	6.65	7.39	
2001	October	7.37	6.64	7.37	
2001	November	7.36	6.62	7.36	
2001	December	7.34	6.61	7.34	
2002	January	7.34	6.60	7.34	
2002	February	7.33	6.60	7.33	
2002	March	7.32	6.59	7.32	
2002	April	7.32	6.58	7.32	
2002	May	7.31	6.58	7.31	
2002	June	7.30	6.57	7.30	

Table 2

## Corporate Bond Weighted Average Interest Rates—Continued

For Plan Years Beginning in:		Corporate Bond Weighted Average	Permissible Range	
Year	Month		90%	100%
2002	July	7.28	6.55	7.28
2002	August	7.26	6.53	7.26
2002	September	7.23	6.51	7.23
2002	October	7.20	6.48	7.20
2002	November	7.17	6.46	7.17
2002	December	7.14	6.43	7.14
2003	January	7.11	6.40	7.11
2003	February	7.07	6.36	7.07
2003	March	7.03	6.33	7.03
2003	April	6.98	6.29	6.98
2003	May	6.94	6.25	6.94
2003	June	6.87	6.19	6.87
2003	July	6.80	6.12	6.80
2003	August	6.75	6.08	6.75
2003	September	6.72	6.05	6.72
2003	October	6.68	6.01	6.68
2003	November	6.63	5.97	6.63
2003	December	6.59	5.93	6.59
2004	January	6.55	5.89	6.55
2004	February	6.50	5.85	6.50
2004	March	6.45	5.81	6.45
2004	April	6.40	5.76	6.40