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DB Pension Plans: 10 Considerations in Light of the Coronavirus Crisis of 2020

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The Covid-19 pandemic has caused economies world-wide to shut down voluntarily. At present, the severity and duration of the disease are unknown. In the U.S., several stimulus bills have already been provided to help people through difficult times. Much is also being done to lessen the impact on our economy. Pension plans have not been spared either and specific relief for plan sponsors has already been enacted. The CARES Act which was signed into law on March 27th, provided a record-shattering $2 trillion in stimulus and included some immediate relief for plan sponsors of single employer defined benefit pension plans. This article summarizes 10 considerations for these pension plans in light of the coronavirus crisis.

ERISA FUNDED STATUS AND BENEFIT RESTRICTIONS

Under the CARES Act, plan sponsors can rely on their funded status certifications for the 2019 plan year to determine if benefit restrictions for 2020 plan year are applicable. Therefore, if a plan offers an accelerated form of payment (e.g., lump sums) and was able to avoid benefit restrictions in 2019, then this exemption can carryover to 2020 regardless of a plan's actual 2020 funded percentage. While this is not likely to be impactful for calendar year plans that enjoyed excess asset returns during 2019, this could be helpful to sponsors with off-calendar plan years, especially those with plan years ending in February, March, or April of 2020 which saw depressed plan asset levels. Plan sponsors who use this lookback year relief can avoid the administrative burden of sending out additional participant notices and participants can keep the opportunity to elect accelerated distributions from their plans as they would have normally done in 2019.

CASH CONTRIBUTIONS AND TAX DEDUCTIBILITY

The CARES Act allows plan sponsors to defer all normally required contributions in 2020 (since its enactment on March 27th) to Jan. 1, 2021. This provision provides immediate cash relief for plan sponsors in 2020. This also gives plan sponsors the ability to make voluntarily cash contributions during 2020 should they have free cash flow on hand, or to make voluntarily cash contributions later during 2020 should their businesses recover. However, the CARES Act does not extend any deadlines for tax deductibility of contributions. For calendar year plans, contributions can be tax deductible (assuming the contribution levels are within the maximum tax deductible limits) for 2019 as long as they are made before Sept. 15, 2020. Plan sponsors that expect to make voluntary contributions in 2020 should consider contribution timing for purposes of tax deductibility. Furthermore, with interest rate relief provisions scheduled to phase-out over the next four years under present law, many plan sponsors will be dealing with increased cash contribution requirements in the near future. Funding up plans with any available cash earlier rather than later could help soften the blow of contribution spikes in the future, absent funding relief.

PBGC PREMIUMS

PBGC insurance premiums consist of a flat dollar and variable rate (subject to a cap) premium. The variable rate premium is

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based on a plan's funded status. Plan sponsors taking the contribution deferral opportunities under the CARES Act could end up paying higher PBGC insurance premiums in 2020. For calendar year plan years, any contributions that are made by Sept. 15, 2020 can be considered as receivable contributions for the 2019 plan year. Making these receivable contributions would result in a higher funded status for the 2020 plan year which could serve to reduce PBGC premiums. This is a consideration for plan sponsors that have to pay PBGC variable rate premiums that are not impacted by (i.e., under) the variable rate premium cap.

PENSION ACCOUNTING EXPENSE

While investment returns soared in 2019, discount rates fell sharply. That resulted in a mixed bag for plan sponsors for purposes of determining pension expense in 2020. For plans with longer durations and more interest rate sensitive cash flows, the drop in the pension discount rates will likely result in a pension expense increase in 2020 relative to 2019. On the other hand, plans with shorter durations may find their liability losses offset by their asset gains in 2019 and thus may experience a reduction in 2020 pension expense compared to 2019. Either way, the one variable component of 2020 pension expense that plan sponsors can still influence is the expected return on assets. Sponsors may want to consider making voluntary contributions in 2020 in order to increase the expected return on assets component of pension expense, thereby lowering the pension expense impact in 2020. Higher pension contributions in 2020 will also help to boost pension funded status as measured at the end of the 2020 fiscal year, which is a determinant for the 2021 fiscal year pension expense.

COMMENCING BENEFITS AFTER NORMAL RETIREMENT AGE

The investment losses suffered in the first quarter of 2020 and the related deterioration of the global economy could have an adverse impact on the retirement prospects of many older employees nearing normal retirement age (often defined as age 65 in many pension plans). Plan sponsors may see more of an aging work force given the tendency for participants to defer retirement and not enter the retirement cohort. While this may lessen liquidity needs for plans, this could translate into higher benefit accruals in plans that aren't frozen. Even in plans where benefit accruals have been frozen, it is possible for benefits to be actuarially increased on account of retirement past a plan's normal retirement age. This may especially be the case for plans where terminated vested participants are able to elect a delayed commencement of benefits. One new possibility brought on by the SECURE ACT, effective Jan. 1, 2020 and just prior to the emergence of the Covid-19 pandemic, is the possibility for plan sponsors to amend their plans to increase the age for required minimum distributions from age 70.5 to 72. Plan sponsors should consider this carefully now given how retirement behavior has been impacted in this new environment.

BRINGING BACK FORMER PARTICIPANTS

Some business sectors such as health care and technology have seen a tremendous increase in the need for the services and products that they offer. Hospitals around the world have been inundated with patients fighting the coronavirus and there seems to be a growing need for more health care professionals, be it on the front lines helping patients or in laboratories working on testing and potential solutions. And what would happen to the global economy if it no longer had the internet at its disposal? It's industries like these that are actually hiring professionals at all levels, including senior talent in the form of retirees. For defined benefit plan sponsors in these industries, an examination of plan provisions dealing with suspension of benefits provisions could be in order. Plan sponsors may want to relax hours limitations on former retirees who resume employment so that they can continue to receive pensions as this may be a deciding factor on whether one may come back to work.

ACTUARIAL ASSUMPTIONS

Many actuarial assumptions for valuation purposes are long term in nature such as mortality rates. Other assumptions such as discount rates and salary increase expectations are more short term in nature. Depending on how long the Covid-19 crisis actually lasts and the actual effect on a plan sponsor's business, this may be a time to reconsider certain actuarial assumptions, especially if a plan sponsor is projecting contribution and pension expense figures over the near term. It may be informative to apply select and ultimate rates for withdrawal, retirement, and salary scale assumptions for ongoing valuations in addition to doing deterministic or stochastic projection valuations. And where we end the year in 2020 in terms of plans' asset returns is anyone's guess at this point given all the market volatility we've seen thus far; therefore, return sensitivity scenarios for 2020 should also be considered.

ASSET ALLOCATION AND (DARE I SAY?) RE-RISKING

The CARES Act included a record $2 trillion in stimulus. Additional stimulus totaling nearly $0.5 trillion was passed on April

21st as a follow up measure. The Fed has taken several measures to boost the U.S. economy and continues to give indications of additional stimulus as it has $4 trillion in available liquidity. But will asset prices regain the peak levels experienced in January 2020? Many investment advisors felt U.S. equities were overvalued at the end of 2019 and some were lowering their return expectations heading into 2020. Then came the coronavirus pandemic and things were essentially turned upside-down. For defined benefit plan sponsors that are following glide path strategies, is now a time to re-risk? Those plan sponsors that recently reallocated funds towards equities which had significantly come down in value after the first quarter of 2020 were certainly happy at the end of April. But what is the expectation going forward? The answer may depend on whether plan sponsors expect the U.S. economy will make it through this crisis or if they feel the economy will fall into a deeper recession. And then there is the consideration of how long a recovery, whether now or well into the future, will take.

DE-RISKING EXPECTATIONS

For defined benefit pension plan sponsors, "pension risk management" and "de-risking" have certainly been buzz words for the past decade. In the post Covid-19 world, the new buzz word seems to be "unprecedented." With discount rates at historic lows, investment losses suffered year-to-date and continued market volatility, it's hard to imagine plan sponsors making additional moves right now to transfer liabilities to third parties in an effort to de-risk. Depending on the immediate business outlook of a plan sponsor, now may not be the best time to engage in measures that would increase short-term costs. However, it's the prospect of future uncertainty and market volatility that may make liability offloading options such as lump sums and annuity purchases more appreciable in the future. The decisions on whether to proceed with further pension de-risking and upon what level of risk is appropriate depend on, among other things, a plan sponsor's risk tolerance and their expectation for the future. How fast we recover from this viral maelstrom will certainly be of influence.

FUTURE FUNDING RELIEF

As noted earlier in the considerations provided for cash contributions, the interest rate relief provisions under current law are set to gradually wear-away starting in plan year 2021 and continue through plan year 2024. The result will be a lowering of funding interest rates and a consequent increase in plan liabilities and, in most cases, minimum contribution requirements. The likely effect of funded status losses stemming from the coronavirus economic meltdown will be increased cash contribution requirements for plan sponsors starting in 2022, right in the middle of the interest rate relief erosion. This double whammy could be a serious issue for plan sponsors. Fortunately, industry associations are already discussing with Congress the need for further pension reform beyond the CARES Act provisions related to defined benefit pension plans. Proposals under discussion include extending the current interest rate relief provisions, spreading investment losses over longer future periods, and limiting PBGC premiums increases. Should any combination of the aforementioned funding relief occur, this could have a dramatic effect on plan sponsor contributions for the near term and could greatly affect many of the other considerations discussed throughout this article.

In conclusion, despite the current uncertainty caused by the coronavirus pandemic, there is prospect for hope for defined benefit pension plan sponsors. The CARES Act, though very basic in its relief, does provide plan sponsors with more time to plan for the future. There are numerous considerations and pathways for plan sponsors to follow going forward. This article offers several considerations that can be individually or jointly explored in order to mitigate pension plan risks in these unprecedented times. ■

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