

# MITIGATING PENSION RISKS IN A VOLATILE ENVIRONMENT

## Insight for Sponsors in the Healthcare Industry



Pension plan sponsors are faced with a volatile political landscape that presents significant opportunities and risks. These are particularly acute in the healthcare industry. The uncertainty facing the Affordable Care Act is just one of the issues that sponsors will face in 2017 and beyond. Many of the nation's healthcare systems have a legacy defined benefit plan, or may be looking at potential merger where this liability needs to be considered.

How can you improve your pension risk outcomes in this unpredictable environment?

### INVESTMENT STRATEGY

Corporate defined benefit plan sponsors saw their funded positions improve 3% to 7% in the fourth quarter of 2016 due to market movement following the U.S. presidential election.

In a departure from recent years, investors are eyeing the possibility that higher inflation and favorable economic growth may improve the outlook for these pension plans.

Plans with a de-risking strategy (glide path) in place are better-positioned to lock in funded status gains as they occur and reduce the likelihood of falling backwards in the future.

Plan sponsors that have delayed planning in hopes of reaching a certain funding level should consider putting a de-risking strategy in place to avoid missing any windows of opportunity.

In addition, as fixed income allocations increase, it's increasingly important to tailor bond portfolios to the plan's liabilities. Plan sponsors should work with an investment advisor to ensure that their long-term strategy is appropriate in the current environment and confirm that their bond portfolio is designed with the plan's unique liability structure at the forefront.

### CONTRIBUTION STRATEGY

In the last couple of years, more plan sponsors have made voluntary contributions in order to meet objectives such as avoiding or reducing Pension Benefit Guaranty Corporation (PBGC) variable rate premiums.

Borrowing to fund pension liabilities became quite attractive and more common during this period, particularly in an interest rate environment that made borrowing cheaper.

Plan sponsors with taxable income may be considering funding up their pension plan in the next several years. If so, they may also benefit from accelerating contributions to apply for the 2016 plan year (if made by September 15, 2017, for calendar year plans).

Corporations should take potential tax reforms into account. They could potentially reduce the corporate tax rate from 35% to 15% if President Trump's plans go into effect. To illustrate, a company that contributes \$50 million for the 2016 plan year could save \$10 million (20% of \$50 million) if the contribution is made prior to when new lower rates take effect.

In addition, other benefits of accelerating contributions are still available, such as reducing PBGC premiums and improving the risk profile of the plan. Though tax reform and the timing of such changes are uncertain, plan sponsors should consider the implications and seek advice from qualified tax professionals prior to taking action.

### LIABILITY SETTLEMENT STRATEGY

Settlement strategies such as lump sums windows have become very common in recent years. One of the major advantages has been to reduce PBGC per-participant premiums, which have been on the rise. Once an individual receives a lump sum distribution of their full benefit, the plan sponsor no longer needs to pay the per-participant PBGC premium for that participant, which has almost doubled in the last five years (from \$35 to \$69 per participant per year), and is projected to increase further according to the PBGC.

In addition, the Internal Revenue Service indicated in proposed regulations released on December 28, 2016, that new mortality tables will take effect for 2018, which means lump sum values are likely to increase, resulting in higher cash outlays. Plan sponsors that are considering offering a lump sum window in the near future should consider the effect of new mortality tables in 2018 along with reduced PBGC premiums and other trade-offs.

### HOW DO WE SUM THIS UP?

Healthcare systems are complicated organizations, managing their liabilities to maintain credit ratings in a competitive environment. Pension risk is a liability many systems face and there are several strategies available that we highlight in this article. PNC has a long history in healthcare and focus on pension risk management. We welcome the opportunity to discuss the unique challenges your organization faces.

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### READY TO HELP

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