

New Pension Relief Provides Flexibility for Plan Sponsors

Defined benefit pension plan sponsors have faced major challenges in recent years from market and interest rate volatility. As plans were looking at the prospect of unwinding prior funding relief, a short-term deferment of 2020 contributions provided through the Coronavirus Aid, Relief, and Economic Security Act was not enough to satisfy the needs for sponsors that continue to be cash strapped. The American Rescue Plan Act of 2021 (ARPA) was signed into law, providing sweeping changes in pension legislation, giving businesses that need it a longer time to recover and the ability to focus on other enterprise decisions. We will highlight key facts and considerations that pertain to single-employer pension plans.

Cash Implications

ARPA expands upon prior funding relief measures by extending discount rate smoothing (that pulls in 25 years of higher interest rates) and introducing an interest rate floor which is expected to result in comparatively lower liabilities. In addition, the period of time to fund new plan deficits will increase from 7 years (originally introduced by the Pension Protection Act of 2006) to 15 years. These two factors should lead to reduced contribution requirements. Plan sponsors may want to consider the following when making decisions regarding contribution strategy:

- Underfunded plans that take advantage of the relief can expect lower and more stable required contributions over the next several years and potentially higher requirements further into the future.
- Well-funded plans should expect little to no immediate impact, but lower future requirements if the plan becomes underfunded over the next several years.
- Increased future variable-rate Pension Benefit Guaranty Corporation (PBGC) premiums (up to the variable rate cap) is expected for plans that

remain underfunded on a PBGC basis (note that the PBGC funded status is much closer to the plan's marked to market funded status).

- Plan sponsors have some flexibility and near-term decisions related to which plan year to reflect the relief (with some changes applying as early as 2019 and some as late as 2022). Implications should be discussed with the plan's actuary.

Balance Sheet Implications

Lower contribution requirements are helpful in providing flexibility and predictability for plans, but sponsors should also consider the impact on their financial statements:

- Lower contributions result in comparatively lower assets and over time could deteriorate the balance sheet funded status and increase pension expense.
- Funding liabilities continue to not reflect the current market environment and discount rates used for generally accepted accounting principles (GAAP) reporting purposes are marked to market which is a better indicator of the plan's health.

Investment Strategy Implications

ARPA is bringing significant changes in future expected plan cash flows which may influence investment strategy decisions. Future losses due to lower investment returns or decline in interest rates can now be amortized over a longer period, which implies more time to close the funding gap. The changes do not indicate an immediate change to strategy as plan sponsor goals and objectives are the key drivers of strategy; however, reevaluation of the investment strategy is appropriate with the following key considerations in mind:

- Plan sponsors will want to consider which metrics are most important. If the economic funded status has been a key area of focus

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that drives balance sheet, pension expense and PBGC premiums, the new law has effectively no impact on investment strategy since none of these measurements are changing.

- Plans preparing for eventual termination would want to consider maintaining their already established de-risking strategies to avoid potential delays.
- For plans sponsors focused primarily on cash contributions that have a de-risking glidepath based on funded status in place, slower

de-risking can be expected if contributions are reduced. Cash-focused plan sponsors can consider increasing risk in the portfolio if this aligns with the organization's risk tolerance and the impact on the plan economics are not as relevant.

COVID-19 provided many economic challenges, and many plan sponsors are welcoming the opportunity that ARPA provides to fund plans further into the future rather than now. Plan sponsors should take this opportunity to discuss the long-term implications and potential strategy changes with their advisors.



READY TO HELP

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