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SINGLE EMPLOYER FUNDING DECISIONS — OPPORTUNITIES AND PITFALLS

The American Rescue Plan of 2021 (ARPA) contains significant changes to the funding rules of single employer pension plans. The new law may significantly reduce contributions to pension plans that are required by law. However, reducing contributions may have other consequences that employers may wish to weigh.

Overview of ARPA's Methods for Reducing Minimum Required Contributions

- *Longer Time to Pay off Unfunded Liabilities* – ARPA permits plans to fund their past plan liabilities over 15 years compared to the current seven years under prior law. An employer can choose to implement this change retroactive to 2019 or 2020, and re-do the calculations, or decide to adopt them in 2021 or 2022.
- *Higher Interest Rates to Value Future Benefit Obligations* – The new law includes provisions that increase the interest rate that plans use to calculate the current value of the plan's future benefit obligations. The use of a higher interest rate results in projected liabilities being valued at a lower amount today and a corresponding decrease in employer contributions. An employer can choose to implement this change retroactive to 2020 and revise prior results or defer use of the new higher rates to 2022.

Unintended Consequences and Related Employer Considerations

While changes to the funding rules may significantly reduce employer contributions, there are other factors that should be considered when developing a funding policy:

- *Impact on De-Risking Strategies* – The new law does not reduce the level of promised pension benefits to plan participants, or the actual amount required to satisfy the obligations. If an employer reduces pension contributions in reliance on the new legislation, certain pension plan de-risking strategies may become more difficult to execute as a result of this disconnect. A plan's funded status must be at least at 80% and a reduction in contributions may make it more difficult to carry out these strategies.

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- *Impact on Investment Strategies* – *Reducing* contributions may make it more difficult to sufficiently fund a plan to implement a liability-driven investment strategy of matching pension payment obligations with assets of similar maturity. As such, more cash is needed to meet ongoing payments that otherwise may have been invested.
- *Impact on PBGC Variable Rate Premiums* – Under-funded single-employer plans pay a variable-rate premium to the PBGC based on the amount of their unfunded benefits obligations (up to a cap based on the number of participants in the plan). The new legislation does not alter the method of calculating unfunded benefits for purposes of variable rate premiums. If employers reduce their pension plan contributions to take advantage of funding rule changes, their unfunded benefit obligations for purposes of calculating variable rate premiums will increase—potentially resulting in increased liabilities to the PBGC.
- *Impact on Financial Statements* – The new rules only apply to the applicable funding rules. Decreases in cash contributions will impact P&L and the funded status of a pension plan as disclosed on an employer's balance sheets and may result in a lower company valuation, potential violations of debt covenants and other impact.

EMPLOYER ACTION PLAN

We recommend that plan sponsors complete an all-inclusive study of the various options that are afforded under the new legislation. The focus should include the short-term and long-term considerations.

This analysis should also consider the various adoption dates that are available under the new law, including the various opportunities to take advantage of the rules on a retroactive basis.

We will continue to monitor the situation. If you have any immediate questions or wish to discuss, please contact Elliot.

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