Coronavirus Advisory

Assessing and Navigating Declines in Pension Assets in the Wake of COVID-19

McGriff

It's no surprise that the market downturn arising from the COVID-19 outbreak has left many U.S. pension plan sponsors uneasy and unsure of the financial effect on their plans. Generally, with a precipitous drop in assets, various measures of a plan's funding health will decline, and plan costs will rise. Is that the situation we are facing right now, and how severe is it?

First of all, the issue depends on the date at which a given measurement is being made. Generally, measurements are made annually, at the beginning of the plan year for regulatory purposes under federal law, and at the beginning of the employer's fiscal year to assess costs under applicable accounting standards.

Regulatory measurements include a determination of annual contribution requirements, insurance premiums to the Pension Benefit Guaranty Corporation (PBGC) and a measurement of the ratio of assets to liabilities. This latter funding ratio drives a number of outcomes, including the frequency of required contributions to the plan, and the possible cutback of benefits for plans that have low ratios. Accounting measurements comprise a determination of annual expense to be reported on the employer's income statement, and a measurement of plan assets and liabilities for the year-end balance sheet.

Thus, for example, organizations whose fiscal and plan years both begin on January 1 will for the most part see their 2020 accounting and regulatory measures unaffected by recent events, having been based on a January 1, 2020 measurement of assets and liabilities. The real question for these employers is whether assets will recover before their next measurement date, January 1, 2021. If not, the table is set for the year-end 2020 accounting disclosures and the 2021 accounting expense and regulatory measures to feel the brunt. On the other hand, an employer whose fiscal year and/or plan year begins April 1st (or in the near future) might feel the effect now (or soon, absent a very quick recovery).

In a further development, on March 27, 2020 the President signed into law The Coronavirus Aid, Relief, and Economic Security Act (CARES Act). In addition to widely-touted economic stimulus payments, the CARES Act also affords some relief to defined benefit plans, with respect to some of the Federal regulatory requirements. These measures include the ability to delay certain plan contributions otherwise due during calendar 2020 until January 1, 2021, and the ability to adopt the 2019 funding ratio for use as the 2020 funding ratio, to mitigate benefit restrictions that could otherwise come into play.

We are therefore advising organizations to consider several courses of action:

1) For employers expected to be unaffected in 2020 due to having a valuation date early in the year, go ahead and confirm that to be the case now on an estimated basis, since 2020 valuations will not be complete for several more months. Then, estimate the effect on the upcoming 2021 valuation based on current assets, trended to the year-end under asset scenarios of improvement, no improvement, and worsening.

2) For employers with other valuation dates, estimate the effect on the current or near valuation date, trending assets into the future under similar scenarios, as needed.

3) Once the accounting and regulatory measures are reasonably estimated, your actuary can advise on actions that might reasonably be taken to mitigate the effects of the downturn. This advice includes working with plan sponsors to advise what specific relief is granted under the CARES Act, and whether or not it offers any given advantage or disadvantage in particular circumstances.

If you would like more information on the effects of the recent market downturn on specific pension programs, both with respect to timing and potential magnitude, and on steps available to mitigate them, please contact Eddie Vaughn, McGriff Retirement Consulting Practice Leader at 336-291-1142, or at **EVaughn@McGriffInsurance.com**.