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American Rescue Plan Act (ARPA) – Implications for Pension Plans

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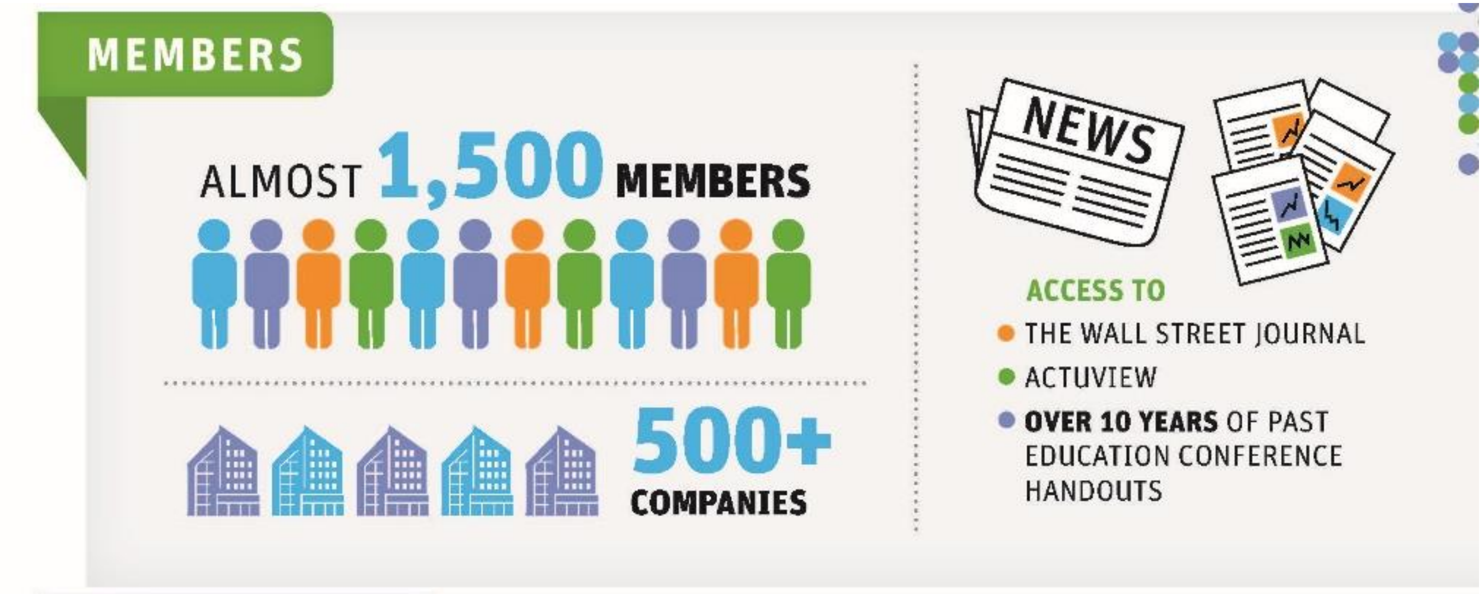
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- Meet at the Annual Meeting and hold conference calls on topics of interest, in addition to online discussion
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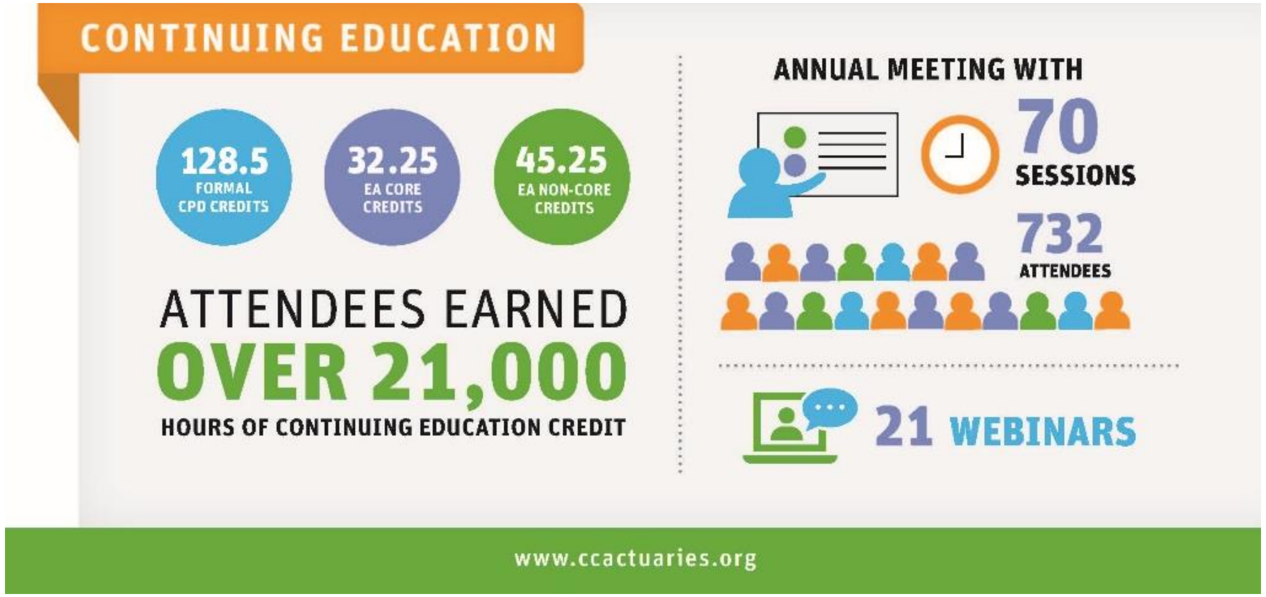
    - To join, email Shannon at speterson@ccactuaries.org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Objectives for today

Overview of Pension Funding Relief Provisions

Potential Transition Guidance

Short-Term and Longer-Term Considerations

Investment Implications

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Funding Relief Provisions – Interest Rates

Provision	Explanation	Comments
Stabilization	▪ 95-105% corridor around 25-year average for 2020-2025; each endpoint moves 5% per year thereafter until it reaches 70%-130% in 2030 ▪ 5% floor on each segment rate before application of corridor	▪ EIR never less than 4.75% through 2025 ▪ EIR never less than 3.5% forever
Timing	▪ Effective for 2020 ▪ Option to defer to 2021 or 2022, for all purposes or just for benefit restrictions.	

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Rates Assuming Current Interest Rate Environment Continues

Plan Year	Pre-ARPA Corridors		Corridors With ARPA Relief		Projected Rates	
	Minimum	Maximum	Minimum	Maximum	Pre-ARPA	Post-ARPA
2019	90%	110%	90%	110%	3.74/5.35/6.11	3.74/5.35/6.11
2020	90%	110%	90% or 95%	110% or 105%	3.64/5.21/5.94	4.75/5.50/6.27
2021	85%	115%	85% or 95%	115% or 105%	3.32/4.79/5.47	4.75/5.36/6.11
2022	80%	120%	95%	105%	2.95/4.36/4.98	4.75/5.18/5.92
2023	75%	125%	95%	105%	2.60/3.95/4.53	4.75/5.00/5.74
2024	70%	130%	95%	105%	2.27/3.57/4.11	4.75/4.83/5.58
2025	70%	130%	95%	105%	2.11/3.45/4.00	4.75/4.75/5.42
2026	70%	130%	90%	110%	1.96/3.34/3.89	4.50/4.50/5.00
2027	70%	130%	85%	115%	1.79/3.21/3.77	4.25/4.25/4.57
2028	70%	130%	80%	120%	1.64/3.08/3.64	4.00/4.00/4.16
2029	70%	130%	75%	125%	1.54/2.98/3.63	3.75/3.75/3.79
2030	70%	130%	70%	130%	1.47/2.90/3.63	3.50/3.50/3.63

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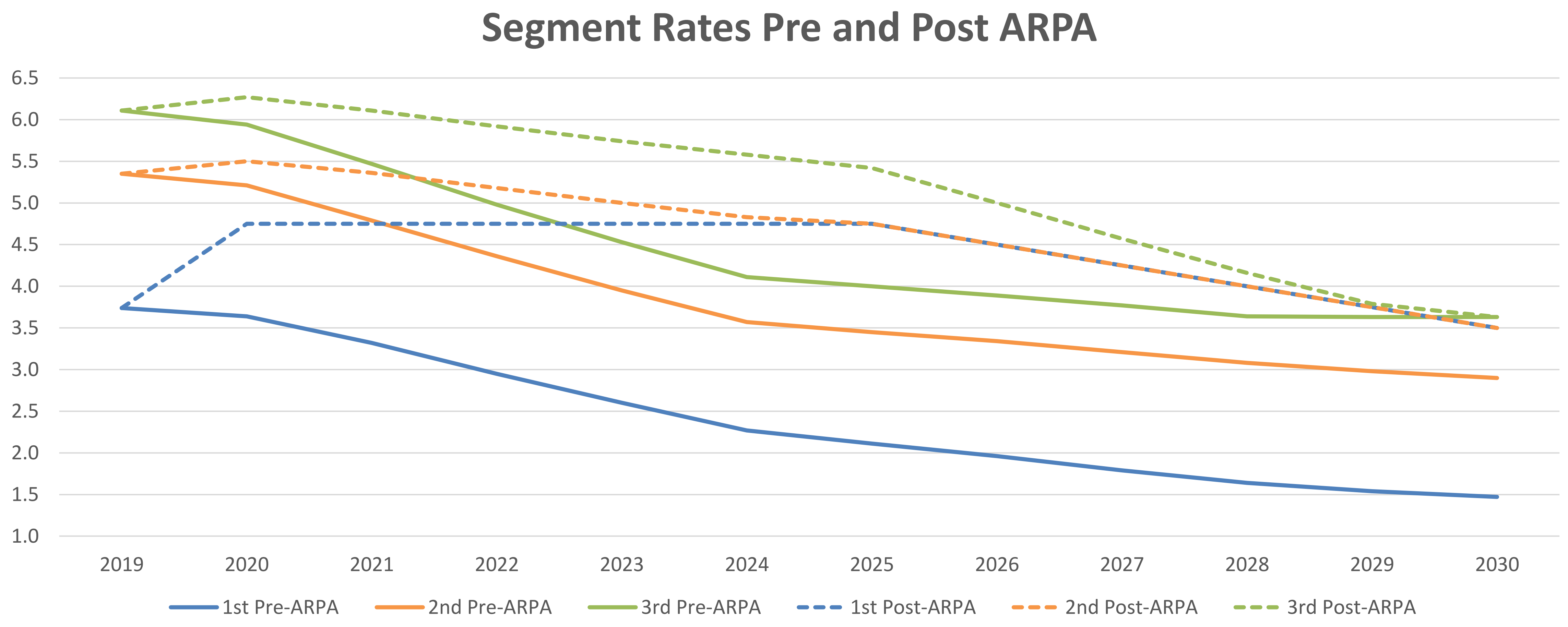
Segment rates – Current Rate Environment



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Illustrative Effects on Funding Target

Duration	Reduction in Funding Target pre-ARPA to ARPA Rates	
	2020	**2021**
Long (15 years)	(4.50%)	(8.50%)
Medium (12 years)	(4.00%)	(7.25%)
Short (8 years)	(3.00%)	(5.00%)

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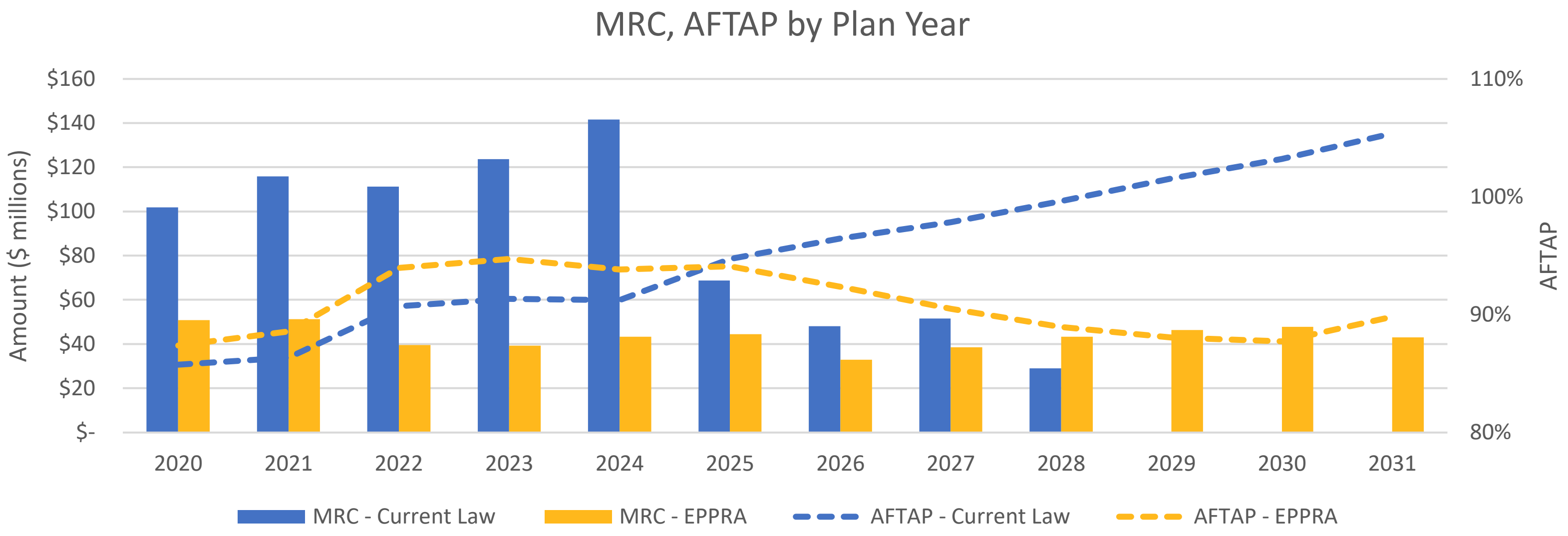
Funding Relief Provisions – Amortization

Provision	Explanation	Comments
Amortization Period	▪ Amortization period changed from 7 to 15 years with fresh start for existing shortfall ▪ New SAIs in future also 15-year amortization	▪ Eliminates 15-year amortization bases from PRA 2010 ▪ Does not affect waiver bases
Timing	▪ Effective for 2022 ▪ Option to make effective 2019, 2020 or 2021	

- Does using smoothed asset values still make sense with 15-year amortization?
  - AVA is biased downward due to cap of 3rd segment rate on expected returns
  - Asset smoothing has less effect post-ARPA due to higher 3rd segment rate

Illustrative Effect on Funding for Large Plan; Assumes Contributions = MRC



- ARPA reduces the Minimum Required Contribution (MRC)
  - 50% in 2020: from $100M to $50M
  - 35% over next decade: from $791M to $520M
  - Less variability due to extension of interest rate stabilization and longer amortization period
- AFTAP after 10 years under ARPA is also lower: 90% vs. 105%
  - Initially greater than current law due to interest rate stabilization
  - Shifts to be less than current law due to the decrease in MRC

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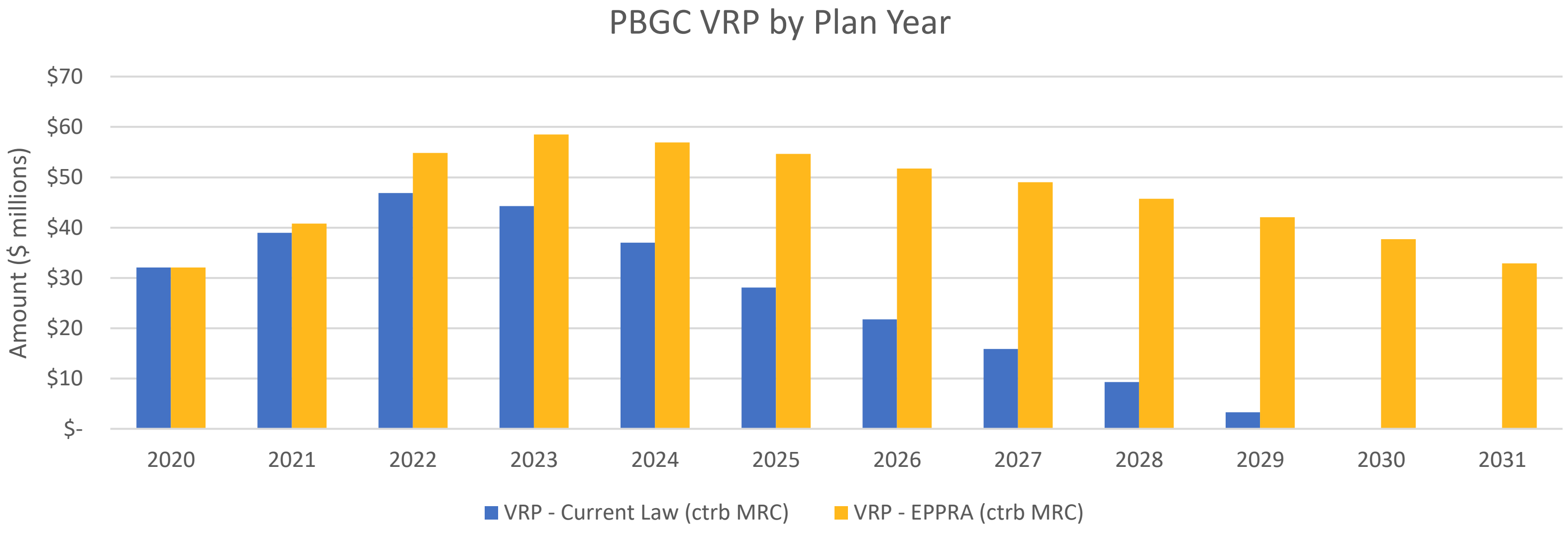
Illustrative Effect on PBGC Premiums; Contributions = MRC



- ARPA increases the PBGC Variable Rate Premium (VRP) by:
  - 5% in 2021: from $39M to $41M
  - 100% over next decade: from $277M to $556M

Example assumes PBGC VRP cap never applies. The increase in VRP would be lower if the cap applies.

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Transition - What Might IRS Allow?

Action	Potential IRS Guidance	Comments
Creating Funding Balance	▪ Deadlines extended to create PFB with excess contributions	▪ If funding balance applied exceeds revised MRC, need to revoke excess use (see below)
Reassigning 2019 contributions to 2020 plan year	▪ Normally would not be allowed once put on 2019 SB ▪ Should be allowed if 15-year amortization adopted for 2019	▪ Contribution must have been made during 2020 plan year or by 1/4/2021 ▪ Likely have to refile SB rather than adjusting 2020 SB ▪ May be desirable for cash flow reasons if deadline to create PFB for 2019 not extended ▪ Reduces 2020 funded status/may increase PBGC premiums
Move contributions to earlier years (e.g., 2020→2019)	• Allowed if not already put on 2019 Schedule SB – No need for IRS permission • May already have done so, but extensions of other deadlines (e.g., PFB creation) affords additional opportunity	• Reduce PBGC premiums if not at VRP cap • Improve funded status for other purposes (§4010 filing triggers, ability to use funding balance, eliminating quarterlies, avoiding at-risk status, avoiding benefit restrictions)

Transition - What Might IRS Allow?

Action	Potential IRS Guidance	Comments
Revoking Excess Use	▪ Deadline not extended under MAP-21 or HATFA official guidance	▪ Informal HATFA guidance – Treat as a deemed reduction and undo ▪ May get a more direct extension of deadline to revoke excess use
Undoing funding balance reductions (or deemed reductions)	▪ Allowed for a limited period	▪ If reduction was based on an AFTAP for a year for which ARPA rates are applied retroactively for §436, OR ▪ If reductions was for non-§436 reasons ▪ e.g., ability to use funding balance
Electing out of full yield curve?	▪ Uncertain	▪ Allowed for MAP-21; not for HATFA or BBA 2015
Funding balance elections before decisions made (e.g., which years ARPA provisions will apply to; what SB contributions will be put on)	▪ No need for special guidance	▪ Use standing elections, or ▪ Use specific elections for more than is likely to be available ▪ Election remains valid up to amount available

Short Term Considerations

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Funding / Contribution Strategy

Does plan sponsor need immediate cash flow relief? Or do sponsor’s funding goals suggest deferring until 2022?

Implementation Considerations

Is relief worth the costs of redoing work?

Avoid Unintended and Undesired Consequences

Moving 2019 contribution to 2020 SB can require refiling 2019 tax return, increase VRP, or cause undesired consequences due to funded status (including in loan covenants); reducing MRC can affect cost or rate recovery

Disclosures in 10Q

Disclose passage of ARPA and anticipated effects on expected contributions

Longer Term Considerations

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Benefits Strategy and Financing

Is providing benefits via the DB plan more attractive with less cash funding risk?

PBGC Premiums

Is reduction in contributions worth increase in PBGC premiums?

Funding / Contribution Strategy

What are sponsor’s funding goals? Avoiding benefit restrictions, §4010 filing, at-risk status, balance sheet liabilities? Glide path to plan termination?

Investment Policy

Revisit investment strategy, including desired investment return / risk objectives and hedging composition

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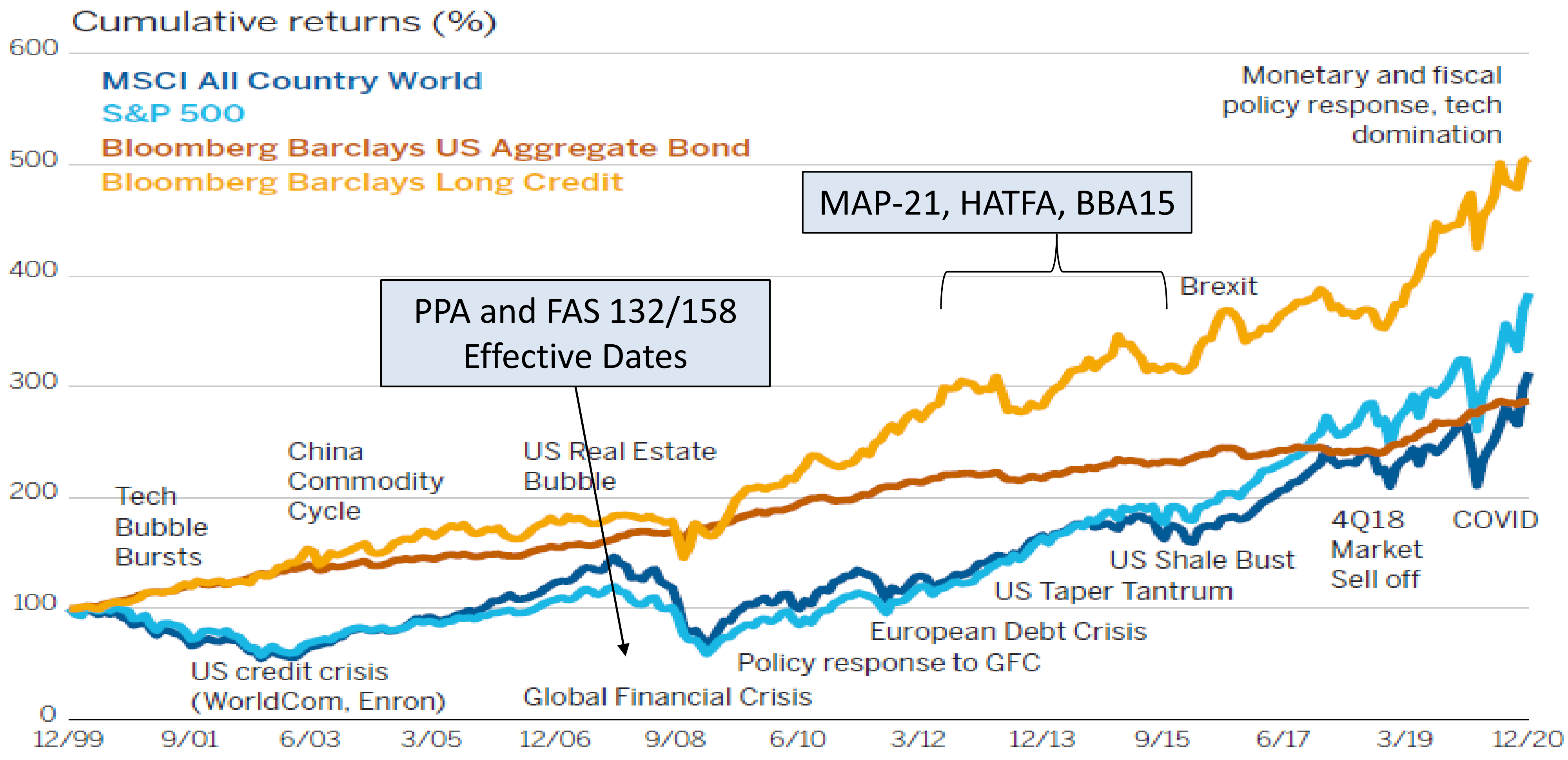
Market & Regulatory Events



Source: Wellington Management

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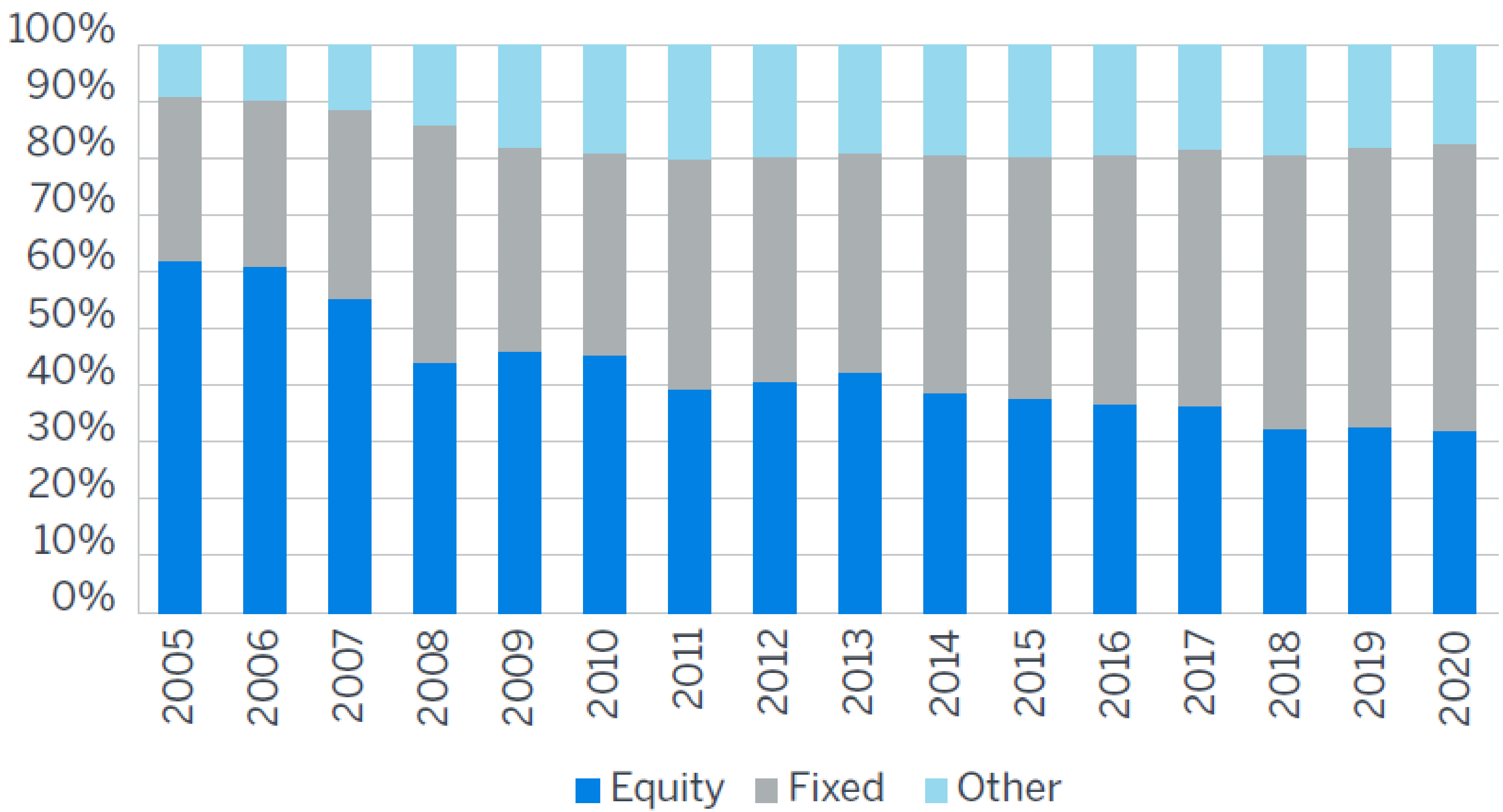
Asset Allocation



Source: Milliman 2021 Corporate Pension Funding Study

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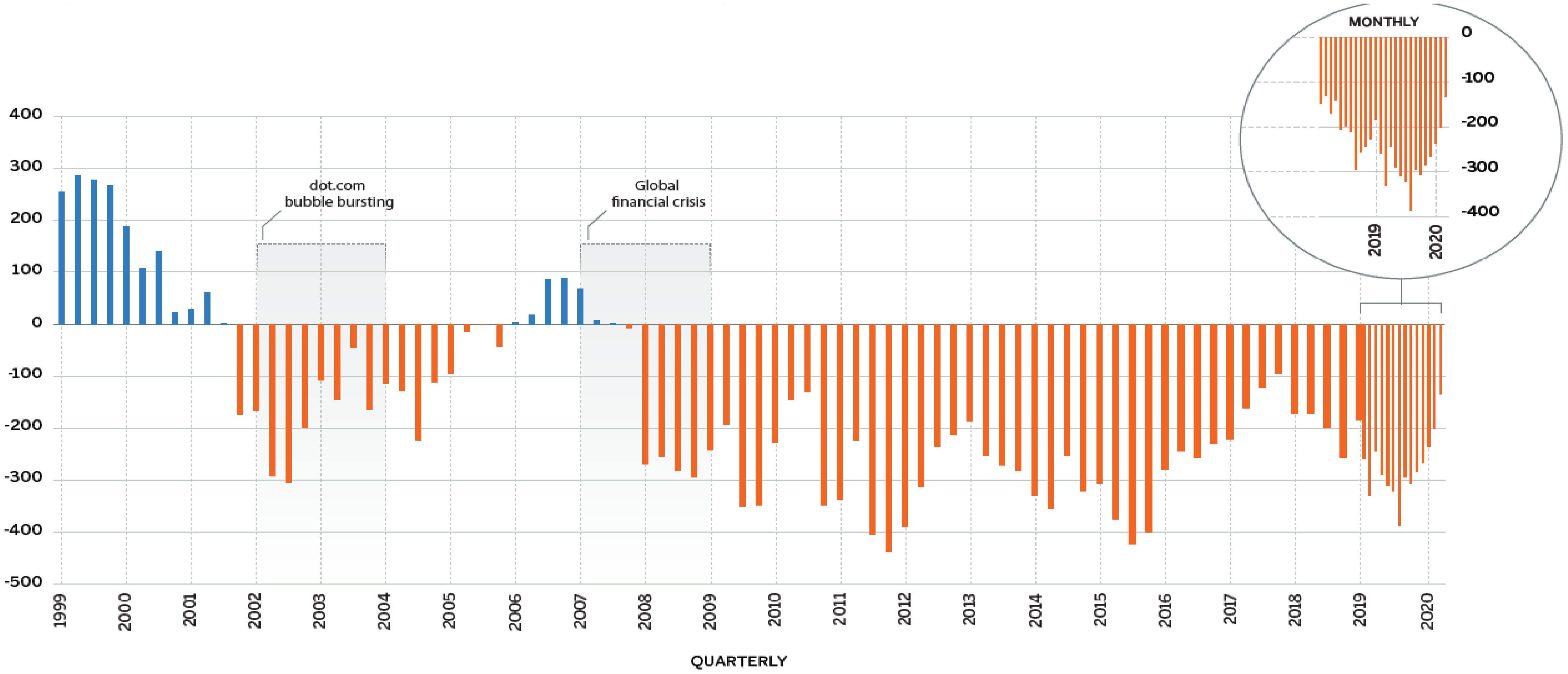
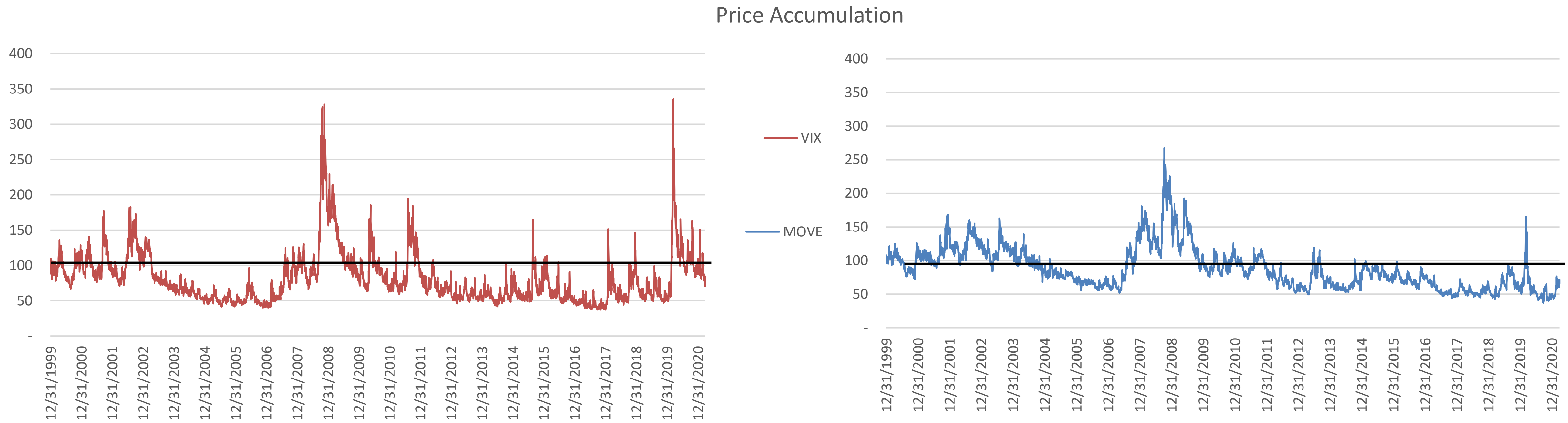
Funded Status



Source: Milliman 100 Pension Funding Index

Current Environment

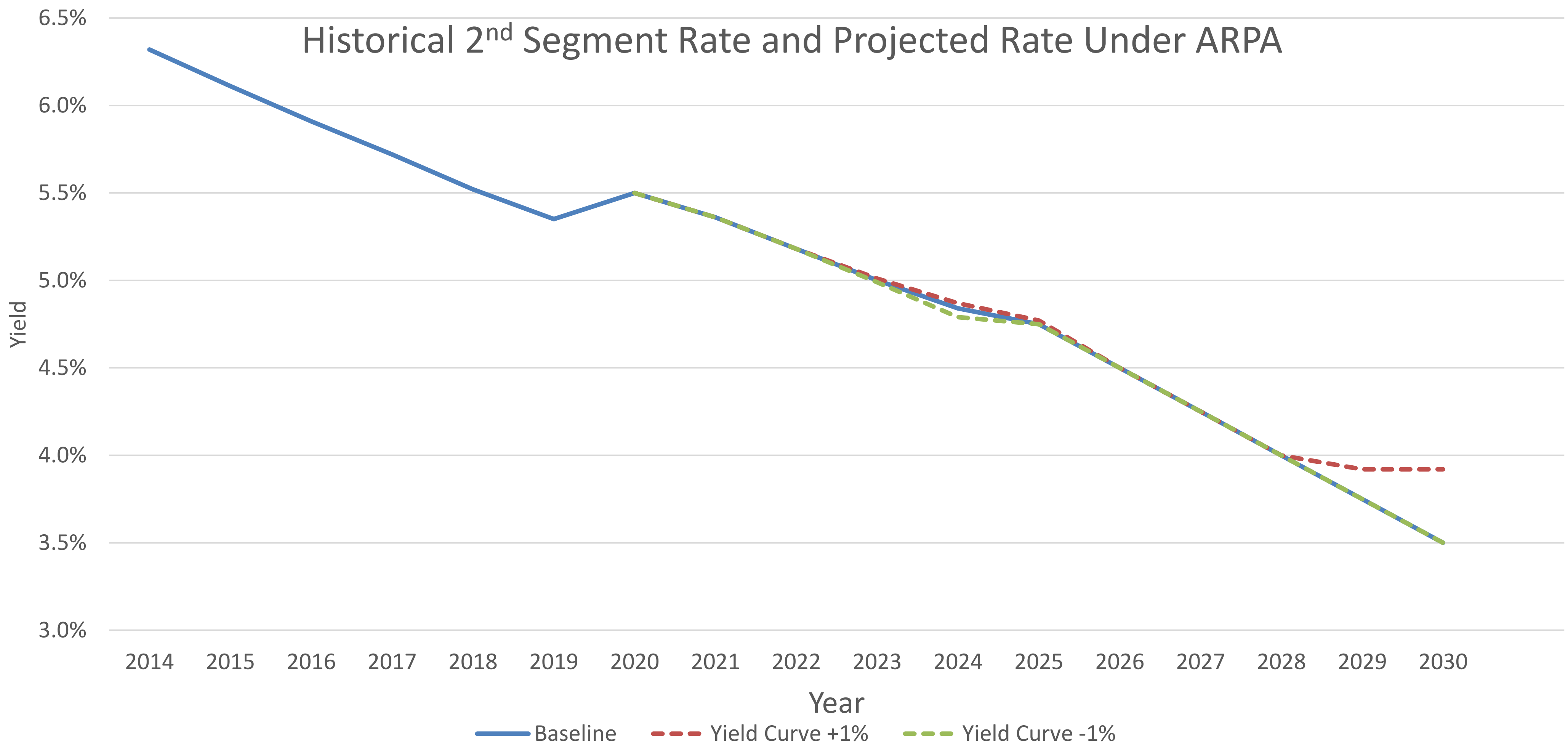


VIX – CBOE Volatility Index is a measure of the upcoming perceived volatility of the S&P 500 (aka the “fear index”).

MOVE – The Merrill Lynch MOVE Index is similar, but measures the perceived volatility of interest rate markets.

As of April 2021. Source: Bloomberg Barclays

Projected Interest Rates



Case Study

Plan Characteristics:

- Frozen
- 73% AFTAP in 2020
- 52% funded on a PBO basis as of 12/31/2020

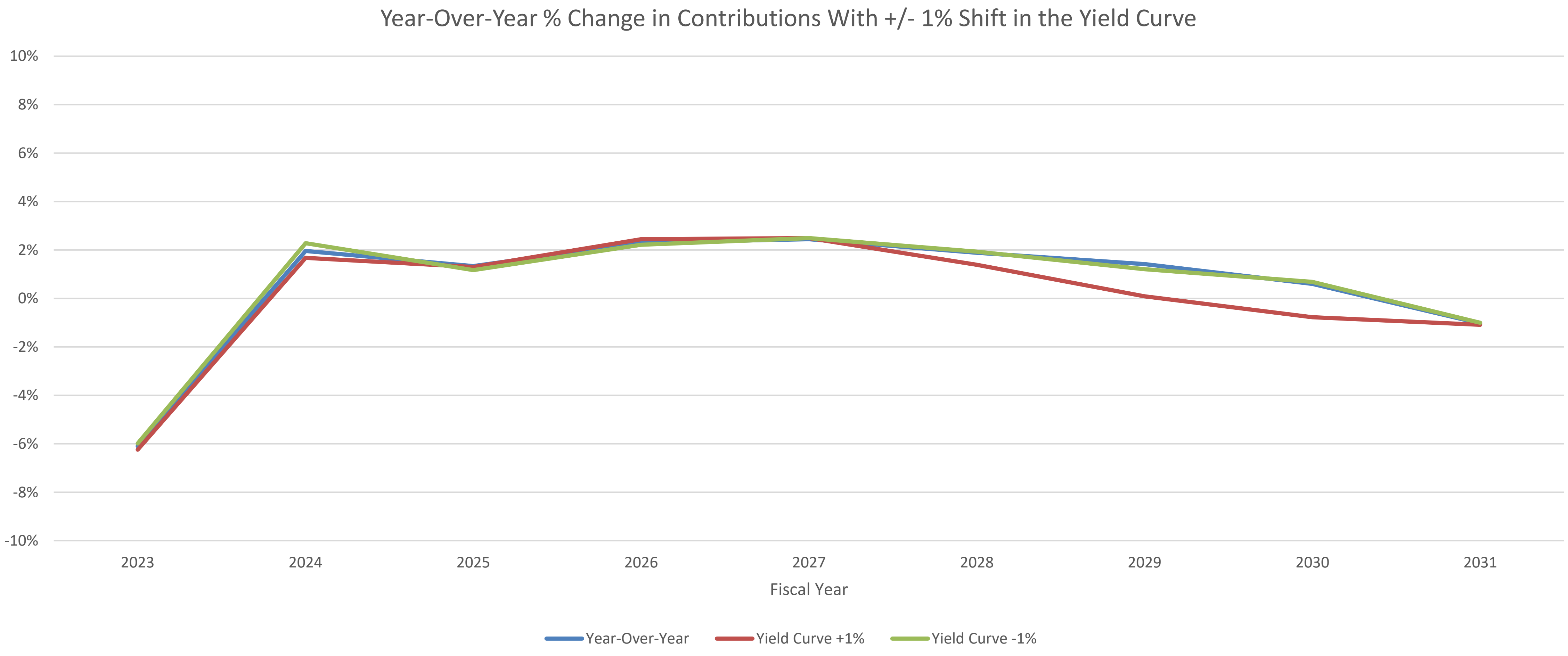
Assumptions:

- ARPA is assumed to apply beginning in 2020
- ROA of 5% unless otherwise indicated
- 2-year smoothed AVA

What we’re going to look at:

- Projected contributions under ARPA
- Scenarios where the yield curve changes
- Scenarios where there is a shock to the asset return

Case Study


Year-Over-Year % Change in Contributions With +/- 1% Shift in the Yield Curve
10%
8%
6%
4%
2%
0%
-2%
-4%
-6%
-8%
-10%
2023
2024
2025
2026
2027
2028
2029
2030
2031
Fiscal Year
Year-Over-Year
Yield Curve +1%
Yield Curve -1%

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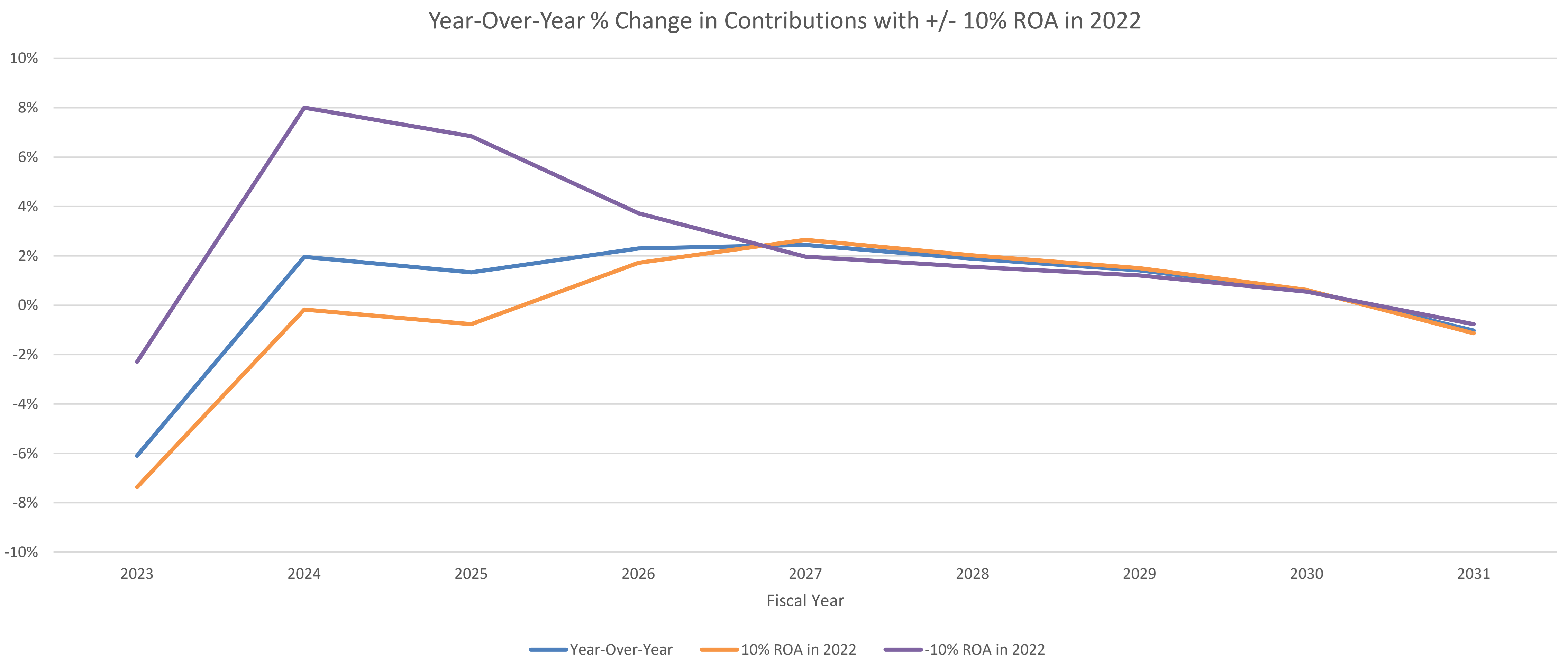
Case Study



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Implications

Interest rates will have very little effect on year-over-year contribution changes over the next few years

Asset returns will have a greater effect on contribution changes compared to interest rate changes, but even those may be muted in the short-term

What will plan sponsors need to consider going forward:

- Diversification strategies to manage funded status downside risk, especially as it relates to asset returns
- Tools that are out there that might not be utilized currently

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Questions?