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DB Plan Contributions: To 2021 and Beyond

While so many people across the country are looking forward to the end of this calamitous year – believing that 2021 will offer remedies for a global pandemic and an ailing economy, plan sponsors now should be plotting a strategy for the upcoming year and beyond.

The Federal Reserve's recent statement of "lower interest rates for longer" impacts defined benefit plan sponsors as they determine an approach to plan contributions – not just for 2021, but likely the next few years. Navigating a possible multi-year stretch of *lower interest rates* will be challenging for pension plan sponsors, particularly for organizations feeling the effects of a pandemic-induced recession.

Forecast to Move Forward

This is an unusual recession, where the economic impact of the pandemic is varied. A number of industries are suffering, while others are seeing strong growth. Certain manufacturers, supermarkets and online retailers, video conferencing firms and other companies enabling remote work have reported *robust sales* in recent months. The hospitality and entertainment industries, auto manufacturers and their suppliers, and numerous sectors of retail and manufacturing industries have been especially impacted through this pandemic.

Steering safely forward will require *forecasting* and guidance from the plan's actuaries, and the first discussion with your actuary should focus on how the organization is currently faring. Organizations that have been hurt financially are likely to experience a "double whammy" as the company's income drops and required contributions to their defined benefit plan increase.

2020 Contributions vs 2021 Cash Flow

Key to the contribution strategy conversation is determining how much the organization can afford to contribute. Some plan sponsors may choose to defer required 2020 contributions to January, 2021, while those companies having a good financial year may opt to contribute on the normal schedule, and may also contribute more than the required amount.

The decision to defer 2020 contributions, effectively at least doubling their contribution requirements in 2021, should be made only after weighing the pros and cons. Deferring may give the company time to come up with the funds needed, but the deferral may strain the organization's cash flow with a large lump sum contribution coming due at the beginning of next year and other contributions required through 2021. Forecasting the organization's financial picture is essential and it's important to get answers to these questions in determining the contribution strategy:

- When will the company's cash flow improve?
- How will our business be affected if another partial shutdown occurs and the economy continues to falter over the next nine months?
- Should the organization finance its contributions now to either accelerate or avoid deferring future funding?
- If contributions are deferred, can the lump sum contribution and other contributions be paid later from cash flow, through borrowing, or a combination?
- Beyond the contribution impact, are there other impacts to the plan or the organization, *such as PBGC premiums*, by deferring or prepaying the contributions?

Look Beyond 2021

For most calendar year defined benefit plans, 2020 contributions will be lower than those required for the 2019 calendar year. Strong asset returns in 2019 resulted in that bit of good news, but plan sponsors should expect contributions to be higher for 2021 and beyond.

Economists are forecasting that the ripple effects of the pandemic on the economy will be widespread, taking several years to fully recover. In light of an expected gradual recovery and the Fed's message of 'lower for longer' interest rates, plan sponsors should anticipate having to manage their plans through a period of lower investment earnings and higher contributions, and understanding the reasonable range of contributions to expect is important. Having a five-to ten-year contribution forecast that incorporates the economic outlook for the next several years will provide valuable insight on future contribution levels and help companies develop a longer-term funding strategy.

With low interest rates, plan sponsors have slowed down their annuity purchases from previous years, but some companies may consider offering a lump-sum window to their eligible participants to continue shrinking their obligations for their plans. These de-risking initiatives can create additional costs, so it's important to understand the impact of these initiatives on future contributions before taking action.

In addition, implementing a *lump-sum window*, not only needs to be fully explored with your actuarial team and legal counsel, the plan sponsor will also need to fully communicate the offer to participants to achieve the desired results. Support staff should be available to answer questions and assist participants with completing and submitting paperwork, if needed. During the pandemic, support should be virtual through call centers, microsites and other electronic meeting solutions.

Conclusion

As 2020 draws to a close, charting a course for DB plan contributions over the next few years is a wise decision that plan sponsors can make. Forecasting contribution levels, developing a contribution strategy, and implementing the plan are integral to moving forward as we experience "lower rates for longer". Findley's actuaries and consultants can offer guidance in developing pension plan contribution strategies to navigate the return to normal.

Questions regarding what your plan's contributions requirements for 2021 and beyond? Contact Tom Swain at *tom.swain@findley.com* or *(615) 665-5319*.