

# H. C. FOSTER & COMPANY

*Retirement and Welfare Plan Actuaries*

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## 2021 EA Meeting Highlights – Spring 2021

The Annual Enrolled Actuaries (EA) Meeting, now referred to as the Enrolled Actuaries Conference, was held via a ZOOM conference during three days in early May. These meetings are produced by the Conference of Consulting Actuaries; and, as in the past, are presented by employees of professional firms and the governmental agencies overseeing retirement and employee welfare plan regulatory matters. Enrolled Actuaries from across the nation regularly attend these Meetings to obtain their continuing educational credits. This year's sessions differed little from the live sessions held previously in Washington DC every year since ERISA was enacted except for 2020 when the Meeting was canceled. These comments from the Meeting are solely our interpretations, and do not represent any positions of the presenters or others connected with the Meeting.

The discussions about capital markets are among the most valuable parts of the Meetings because they provide insight to emerging fixed income and equity market trends. Investors search the capital markets for investment indicators. Following are observations with some contradictions from the session on capital markets that may be meaningful in aggregate for all investors:

- The dampening effects of the COVID-19 shutdowns was frequently noted in discussions
- The U.S. stimulus plan has hugely impacted our outlook on the economy
- The ratio of governmental debt to GDP increased significantly during 2020
- Inflation expectations for the U.S., U.K., and Germany have spiked sharply
- Bankruptcies have fallen, but this may be due to a delay in the ability to take action
- Market risks have abated, but other risks persist
- Interest rates will increase, but not necessarily for fixed income investments
- Credit spreads are near historic lows, i.e., lesser quality bonds of the same duration are not paying much more than higher quality bonds of the same durations for the extra incurred risk of default
- Historically, low yield have led to low returns
- Equity values have spiked since the downturn earlier in 2020
- There are signs of speculative excesses
- Historically, high P/E ratios have resulted in low returns
- S&P 500 index percentages are concentrated in fewer companies
- Predictions of U.S. equity returns for the next 10 years not optimistic
- We could be looking at low interest rates and low GDP growth for the next ten years

Our private forecast for this Newsletter is a negative economic outlook for the next ten years that bodes badly for underfunded pension plans and retirees. A plan's assets can easily be less than one-half the cost to settle all benefit obligations at one time under the required Lump Sum Distribution (LSD) present value assumptions, or through possibly more expensive Single Premium Life Annuity Contracts from life insurance companies. Following are the events leading to this situation:

- The Pension Protection Act of 2006 (PPA '06) imposed stricter minimum funding requirements through conservative mandatory mortality and interest rate assumptions.
- Interest rates fell to near zero (-0.0%) after 2008, and have remained there under the quantitative easing strategies of the Federal Government through cheap money at little cost to borrowers. Employers could not meet their minimum funding requirements resulting from low valuation interest rates.

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- Congress liberalized the more stringent PPA '06 pension funding requirements through several Pension Acts to dramatically lower otherwise much higher minimum funding requirements.
- But, the abnormally low valuation interest rates for LSD present values under PPA '06 remained, causing “fully funded” present values much less than LSD present values that most employers can not fund. This, despite having met or exceeded their annual minimum funding requirements.
- There appears little recognition among regulators of the need to align mandatory LSD and minimum funding valuation assumptions.

This disparity could have been corrected any time after 2008. Instead, the American Recovery Plan Act of 2021 (ARPA), signed into law on March 12, 2021 further weakens the minimum funding requirements:

1. ARPA replaces the 7-year amortizations of each year's loss or gain in the unfunded liability with a single 15-year amortization requirement. IRS Guidance has not been issued as to how the 15-year amortization rules will apply. Although mandatory for plan years beginning in 2022, Plan Sponsors can apply the 15-year amortization schedule retroactively for plan years beginning in 2019, 2020, and 2021 with the prior remaining bases taken to zero (\$-0-). Plan Sponsors who already filed their 2019 and 2020 Forms 5500 are permitted the ARPA elections retroactively with amended re-filings. It is impossible to finalize any results under the ARPA elections until later when IRS Guidance is available. The cost of revising 2019 and 2020 valuations for retroactive elections may not be justifiable.
2. ARPA sets a grandiose scheme for interest rate manipulation through 2030, coined *Interest Rate Stabilization*. The 10% corridor for adjusting maximum and minimum interest rates around the 25-year average rates is reduced to 5.0% for 2020. This increases permitted valuation interest rates, thus lowers the minimum contribution requirements. The interest rate corridor will not widen until the 2026 plan year when it begins widening by 5.0% per year until it reaches 30% for 2030 and thereafter. The 25-year averages will be subject to a 5.0% floor. This action does more to defer scheduled contribution increases than to lower current funding requirements. The ARPA's interest rate stabilization will not survive until 2030 with changing regulatory bodies.

We note the following:

1. Election of the 15-year amortization schedule can easily lower the past service minimum funding cost by \$10,000 based on the applicable segment interest rates for minimum funding. Decreased minimum funding requirements resulting from higher valuation interest rates are not predictable with uncertain interest rate trends.
2. ARPA by itself will increase unfunded liabilities for employers who do not fund their plans substantially above the regulatory minimum requirements.
3. Absent regulatory responsibility and/or a major economic disruption, free market forces must take control of the credit markets to regain a historical 5.0% real return rate with moderate risk above purchasing power losses from monetary inflation. This will not occur so long as the Federal Government stifles free enterprise through cheap money stimulus programs, confiscatory taxation, and policies that regulate us out of business through regulatory mismanagement.

Please e-mail any questions or comments.

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