Fixer to Fabulous!

What’s next for your Diocesan Pension Plan

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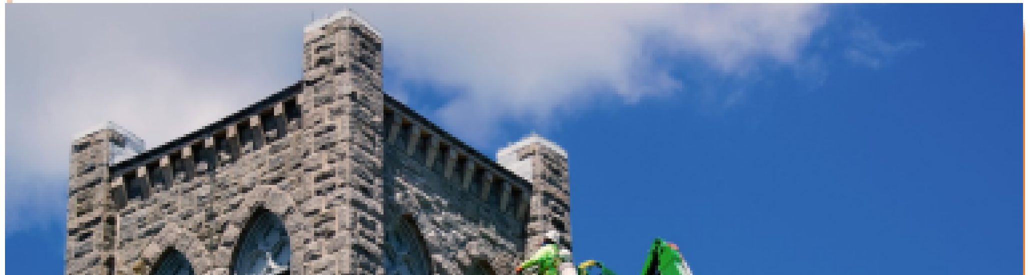
What's next for your Diocesan Pension Plan

Typical goals of the Diocese

- Sustaining the pension plan so that the last retiree receives all of his/her annuity benefits
- Providing meaningful retirement annuity benefits to priests for the long-term (including new priests)



- Managing the under-funded pension plan(s)
- Reduce risk and/or shrink the size of the pension plan
- Balance between pension and 403(b) benefits

Convocation
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– Typically contributions for a Lay Plan are based on an annual assessment, and a percentage of a parish, school or agency's payroll is contributed to the pension plan from the employer

– Many dioceses are facing a smaller active workforce than years past, limiting the contributions to the pension plan

– Does your Lay Plan have a realistic funding policy that can sustain the plan for the long-term? What is the time horizon for full-funding, and how do you monitor progress?

– For frozen Lay Plans, it's challenging for the divisions to continue to pay into the pension plan as it offers no future benefits, and leadership would rather devote employer funds to current benefits (like the 403(b))

– Often dioceses look for other ways to fund pension benefits, such as
  – Allocating a portion of a property sale to the pension program
  – Collections and charitable contributions

– What if the plan is well-funded or over-funded? Are asset allocations set appropriately to de-risk the investments for market adjustments?

– Typically contributions for a Priest Pension Plan are funded on a per head basis ($X per priest)

– Typically Priest Pension Plans are open plans, allowing priests to earn future benefits and new priests to enter

– It is common for Priest Plans to have retirement ages into the 70's, with the possibility for priests to receive pension plans while still in-service. This can reduce expenses outside of the pension plan if the priest is made "whole" by the annuity from the pension plan

– For under-funded pension plans, often dioceses look for other ways to fund pension benefits, such as
  – Allocating a portion of a property sale to the pension program

– Collections and charitable contributions

May 2024

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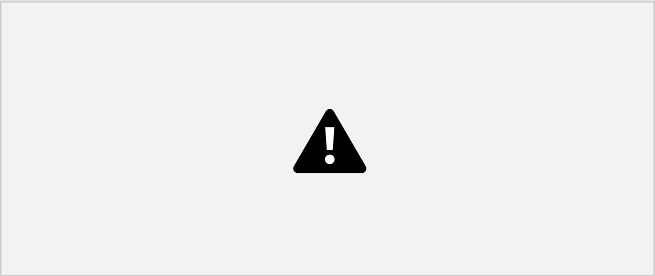
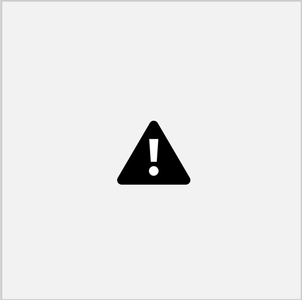


Plan Design Adjustments

Asset Strategies

Settlement



Strategies

If the current funding of the pension isn't enough, or not sustainable, there are other options to consider:– Freezing a pension plan

that is still open

– Reducing benefits to a pension plan that is still accruing

– Reducing or removing any ancillary benefits the plan may provide, such as Medicare reimbursements, burial death benefits, or other reimbursements

– Provide a limited lump sum window, aligning the cashout amount to the plan's funded status

– For example, the plan is 80% funded, so provide a cashout of 80% of the benefit

– Purchase annuities through an insurer

– Often comes with a "surcharge" as insurers measure liabilities differently than diocese funding measurements

– **Challenge:** Once a plan is better funded, if asset allocation is de-risked, the liability interest rate likely needs to be lowered

Lump Sum Window Sample Case

Sample Lay Plan that froze in 2020 has the following funded status as of January 1, 2024

Total Liability *(uses an interest rate of 6.50%)*	$100,000,000
Active Liability (300 actives)	$10,000,000
Deferred Liability (400 deferred)	$15,000,000
In-Pay Liability (900 in-pay)	$75,000,000
Assets	$75,000,000
Funded Status ($)	($25,000,000)
Funded Status (%)	75%
Annual Benefit Payments	$10,000,000
Annual Compensation	$25,000,000
[illegible]n (10% Assessment)	$2,500,000

Lump sums can be offered to all participants as an optional payment through a window

– The lump sums would be calculated based on the 75% funded status

    - For example, if the liability of an individual participant was $20,000, then the lump sum offered would be ~$15,000 (75% of $20,000)
- The lump sum can be offered as completely optional
    - Some plans will make a lump sum mandatory if it’s below a certain threshold (for example, the ERISA plan amount of $7,000)
- Lump sums are offered through a “window”, with an election period of typically 30 to 45 days
    - Communication is key, so that all participants understand what the offering is, what it will do to their future benefits, and why the Diocese is having this offer
    - Typically a lump sum is viewed favorably as it is an option, but there can be some pushback on the funded status reduction
    - In-person meetings are key to the offer so that participants can be heard and get their questions answered

The funded status as a percentage is retained through the offering (75% pre- and post) but the funded status as a dollar amount is improved by almost $12M

Total Liability *(uses an interest rate of 6.50%)*	$100,000,000		($47,500,000)	$52,50
Active Liability (300 actives)	$10,000,000	85%	($8,500,000)	$1,5
Deferred Liability (400 deferred)	$15,000,000	60%	($9,000,000)	$6,0
In-Pay Liability (900 in-pay)	$75,000,000	40%	($30,000,000)	$45,0
Assets	$75,000,000		($35,625,000)	$39,37
Funded Status ($)	($25,000,000)			($13,125
Funded Status (%)	75%			

Pre-cashout, the current funded status is 75% with a $25M deficit. By 2041, the assets are completely depleted, yet there is $19M left in future liability (i.e. the

Assumptions:

- *Salaries increase by 2.50% per year*
- *Active population declines by 3.00% per year*
- *Contributions to the plan are 10% of the total active compensation (those in and not in the pension plan)*
- *Liability is measured by 7.00%*
- *Assets expected to return 7.00% annually*
- *Annual plan expenses of $500,000, increasing by 2.00% per year*

Post-cashout, the funded status
is currently 75% with a $25M
deficit. However, if the contributions remain the same
(10% of compensation for the
entire active population), by 2035 the plan is fully funded

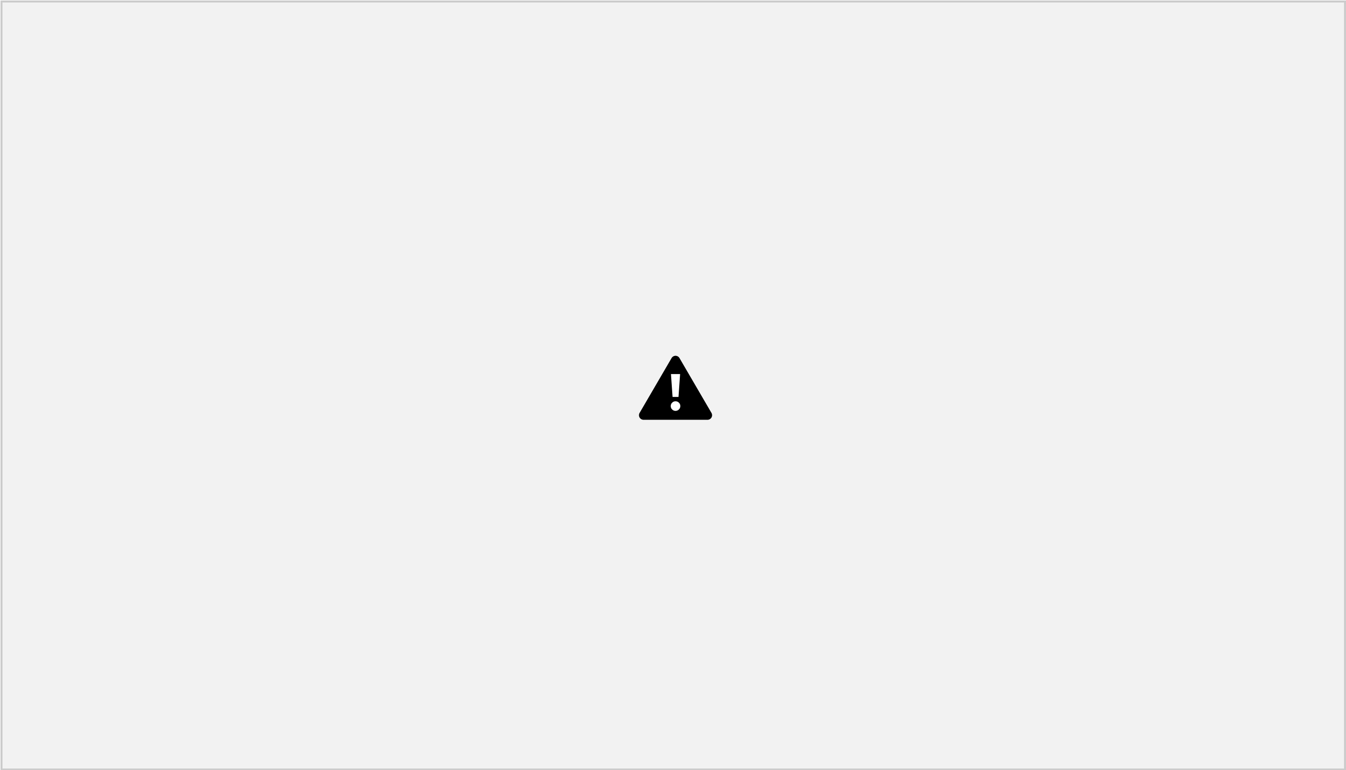
Considerations for a reduction in the contributions can be made as the funded status

Assumptions (same as prior slide, with the following additions):

- *Lump sum take rate by status is 85% for actives, 60% for vested terminated participants, and 40% for* retirees

• *Lump sums are offered at 75% of the accrued benefit to tie to the current funded status*

Post-cashout, expected benefit payments reduce by about 40%, and stay considerably less than the Pre-cashout plan cashflows



- Is your data ready for a cashout?
  - Need final accrued benefits for all participants included in the offer
  - Data cleanup may need to be an initial step, or an audit of the benefit calculations to ensure compliance
- How is the plan administered today?
  - If administration is done internally, do you have a succession plan when key personnel retire or terminate?

– Often there is an integral person on the HR team that is the plan administrator, and if that person is no longer there, historical knowledge is lost

Annuity Purchase

Purchasing annuities is a way to transfer liability from the pension plan to an insurer

– Currently, interest rates are quite high, which is favorable for pension plans (higher interest rate = lower liability)

- In April, annuity purchase rates have been in the low 5.00% range
- This can be very favorable for pension plans considering this option

- An advantage to participants to have annuities purchased on their behalf means their annuity is secure (vs. typically unprotected in a diocesan pension plan)
- However, many diocesan plans measure the liability at a long-term interest rate
  - For example, the sample Lay Plan we considered used a 7.00% interest rate
  - To purchase annuities, the insurer will use current rates. At a 5.00% interest rate, this would mean purchasing annuities would come with a 15% to 20%+ "surcharge"
  - For example, removing $10,000,000 in liability may have a cost of $12,000,000 or more ($2,000,000+ surcharge)
- This is an option to monitor, and be ready to "pull the trigger" when the situation is right for the pension plan
- If considering a lump sum window, we recommend doing that step first to see how many retirees are left after the window

Managing the Pension Plan for the Long-Term

Even if a lump sum is offered, or annuities are purchased, there is still the remaining plan to manage

- If the pension plan is frozen, the ultimate goal is to fully terminate the plan when the time is right
  - Monitor funded percentage, and continue to adjust the assessments as the funding status improves
  - Can “borrow to fund” if have access to favorable loans (possibly through Diocesan organizations)
- For any plan status (open, frozen, etc.) continuing to monitor and update the asset allocation is key
  - As the funded status improves, review the allocation to preserve gains and de-risk the asset mix to avoid full impact of market downturns
  - One note of caution – as the assets become more fixed, there is a need to assess the interest rate used to measure liabilities (less risk in asset mix typically requires a lower interest rate to measure liabilities), especially if a long-term interest rate is used to measure liability
  - This can have an adverse impact on the funded status, so as you look at asset allocation keeping the liability measurement in mind is key
  - **Key question:** What is the “end-game”, if any, for the pension plan? This will help you define both the liability interest rate and the asset allocation

Thank you.

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