# The Bulletin:

Welcome to The Bulletin, a Milliman publication covering church retirement plans (church plans). This series will focus on issues related to the long-term success of church plans and compliance considerations. Chapters in this series will focus on three core principles that are often considered in church plans—***benefit adequacy, benefit equity,*** and ***benefit security***.

## Three core principles

Church plans often look to balance three core principles: *benefit adequacy*, *benefit equity, and benefit security.* Importantly, the weights placed on each of these principles will vary from one organization to the next and will be subject to the organization's values as well as current facts and circumstances. We will discuss each of these principles in more detail, and how they interact with each other, but first let's take one step back and briefly discuss pension plans in general.

## Brief history

Defined benefit (DB) pension plans have been around in the United States for over 100 years. Under this type of plan, members are guaranteed a "defined benefit" for life once they retire. While the first plans started in the late 19th century, they really gained popularity once contributions became tax-deductible in 1921. By 1960 about half the private sector workforce had a DB plan. With the increase in the number of DB plans, some plans began to fail as they did not make adequate contributions to fund the benefits promised under the plan. As a result, the Employee Retirement Income Security Act (ERISA) was passed in 1974. ERISA provided for specific contribution requirements among various other rules designed to protect retirement plan participants.

However, Congress provided church plans with an exemption from certain parts of ERISA, including minimum funding and reporting. With this exemption, church plans retained their ability to set the contribution rate for their pension plans. However, with this freedom came the responsibility to establish contribution rates that would properly fund the pension plan over time. While several large church plan sponsors have been successful in maintaining well-funded plans, some church plan sponsors have struggled to maintain an adequate contribution rate. As a result of inadequate funding over the past 10 years, several church plans have reduced benefits already earned. While ERISA prevents benefit cutbacks for most pension plans, church plans are exempt from this rule.

## Unique considerations for church plans

With that background, we can now discuss the unique considerations for managing church plans. As noted above, church plans are not subject to the minimum funding requirements under ERISA. However, church plans also often lack the deep pockets to increase contributions substantially if the need arises. Therefore, it is important to monitor the plan's long-term projected funded status and ensure that the current contribution level is adequate to cover the benefits promised. By doing so, a plan sponsor can ensure the long-term *benefit security* of its plan.

Another factor important to many church plans is *benefit adequacy.* While many companies have transferred the primary burden of saving for retirement to employees, church plans have maintained a paternalistic approach to ensure their plans will provide retirement security for their participants. This is particularly true for plans that provide benefits to clergy and lay members of the church. There is a recognition that compensation for these roles is often less than what is available outside the church and that it is appropriate for the church to ensure its employees are provided for in retirement, after a career of service to the church. Furthermore, where active clergy receive church provided housing, the considerations around *benefit adequacy* should address the new housing costs that clergy members will face in retirement.

The third principle that church plan sponsors often consider is a *benefit equity.* This concept has two applications: 1) equity between low-paid and high-paid participants, and 2) equity between different generations of participants. Church plans look to ensure that clergy who serve in poorer, lower-paying locations are provided for in retirement in the same manner as clergy who serve in more affluent locations. One way in which this can be accomplished is by weighting the benefit formula to provide a higher formula for a first tier of compensation. For example, a benefit formula may provide 2% for the first $20,000 and then 1% for compensation above $20,000.

The second concept of *benefit equity* is also known as intergenerational benefit equity. In deciding on current benefit policy, sponsors may look at the impact on future participants and retirees. For example, if the plan builds up a surplus, the trustees may use that surplus to increase benefits. However, in doing so, they may consider implementing a smaller increase with the ability to maintain that increase for many years in the future, as compared to a large increase that may not be sustainable for future participants.

## Balancing act

It is important to note that the interplay between these three principles — *benefit adequacy, benefit equity, and benefit security* — is crucial. While all these principles may be important, it's all about the balance between them. If a plan already provides for a meaningful retirement benefit (*benefit adequacy*), the sponsor may want to look to build the surplus and protect against a market downturn (*benefit security*) before any additional benefit increases. However, a plan that only provides a modest benefit may consider trying to improve benefits while focusing on benefit security at the same time. Consider this: the richer the benefit level, the more benefit security the plan should have. Also, keep in mind that too much focus on benefit security, may result in building up a large surplus and impact intergenerational benefit equity.

## Summary

In conclusion, each church plan sponsor needs to decide for itself what weight to place on each of these principles. Considering the plan's current benefits, funded status, and organizational values, a careful ongoing balanced approach to benefit adequacy, benefit equity, and benefit security will position the plan for success for current and future generations of participants.

Look for upcoming articles as we take a deeper dive into these core principles as well as compliance considerations unique to church plans.

**Your Milliman actuary**

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For more information about The Bulletin series, see prior articles here.

Do you have a question about your defined benefit pension plan? Write to us at thebulletin@milliman.com.