Defined Benefit Retirement Plans: Challenges, Changes, and Benefits for Cooperatives

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Background

- In a pension galaxy, a long time ago…
- Before 1978...
- There were defined benefit plans…and…
  - Stock bonus, profit sharing, and money purchase pension plans
  - Tax sheltered annuities
  - But no 401(k) plans
- Types of retirement plans
  - Single employer plans
    - Plan covers employees of one employer (one controlled group)
  - Multiple employer plan
    - Plan covers employees of multiple unrelated employers
  - Multiemployer plan
    - Plan collectively bargained and maintained by multiple employers (usually within same or related industries) and labor union

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Advantages of Defined Benefit Plans

- **Advantages**
  - **Recruiting and retention in areas of low unemployment**
    - **Defined benefit plans can have longer vesting schedules and have benefits that increase with service, which encourage retention**
  - **Recruiting of senior management**
    - **Defined benefit plans offer added incentive in recruiting senior management for agricultural cooperatives located in rural area**
  - **Retirement readiness**
    - **Defined benefit plans and annuities provide for more certainty in retirement**
    - **Unless employees feel ready to retire, more likely to delay retirement**
  - **BUT…**
    - **Advantages may be less for millennials**
    - **Advantages may be less for coops in urban versus rural areas**

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Disadvantages of Defined Benefit Plans

- **Disadvantages**
  - **Additional regulation**
    - **Subject to PBGC in addition to other agencies**
  - **Multiple employer plan complexities**
    - **Advantage of minimizing costs and spreading costs**
    - **Risks of employer withdrawal**
  - **Mergers and acquisitions**
    - **Often restrict transactions**
  - **Administrative expenses**
    - **Actuaries**
    - **Accountants**
    - **Management**
  - **Other challenges noted later**

Meadowland Farmers Coop Background

- Meadowland Farmers Coop
- Serving community since 1905
- Employees
  - # of Full Time Employees: 124
    - 18-34 Years Old: 43
    - 35-54 Years Old: 43
    - 55+: 38
  - # of Part Time Employees: 33
    - 18-34 Years Old: 23
    - 35-54 Years Old: 4
    - 55
- 58% of employees over age 35

Meadowland Farmers Coop Background

- **Area served**
- **Services**
  - Grain
  - Agronomy
  - Energy
  - Feed

Meadowland Farmers Coop Background

- **Target income replacement by retirement: 70%-100%**
  - **Of this amount:**
    - **Approximately 30% to 60% is Co-op retirement plan (defined benefit plan)**
    - **Approximately 20% to 40% is Social Security**
    - **Some remaining portion is from 401(k) plan**
- **Co-op retirement plan background**
  - **Multiple employer plan**
  - **338 employers**
  - **Assets are pooled into one giant trust fund**
  - **Employers share in funding, benefit payments, and administrative costs**
  - **Investment and demographic risks spread across all employers**
  - **Favorable funding rules**
  - **Favorable accounting rules**
  - **Complete portability of benefits**
  - **Net result: extra security for employees**

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Defined Benefit Plan Discussion

- Discussion on defined benefit plans and cooperatives
- Audience questions, thoughts, and experiences
  - Requested and appreciated!

Thinking About Defined Benefit Plans
Attracting and Retaining Employees

- **Remaining slides are background information and take away materials**
  - **Designed to provide additional information**
  - **Panelists are happy to discuss, but want to provide time for an open discussion on defined benefit plans**

Developments
Shift to Defined Contribution Plans

- **Single employer plans with 100 or more participants**
  - **Note that adoption of cash balance plans has slowed decline in number of defined benefit plans**

	DB Plans	DC Plans
1975	18,016	8,350
1980	22,424	12,978
1985	22,619	23,279
1990	17,521	33,035
1995	15,371	44,115
2000	11,866	56,621
2005	10,102	66,123
2010	8,741	74,199
2014	7,643	76,934

- **Source**
  - **DOL, EBSA, Private Pension Plan Bulletin Historical Tables and Graphs 1975-2014 (https://www.dol.gov/sites/default/files/ebsa/researchers/statistics/retirement-bulletins/private-pension-plan-bulletin-historical-tables-and-graphs.pdf)**

Developments
PBGC Premiums

- **Per capita (per participant premium)**
  - 1990 – $19 per participant
  - 2005 – $19 per participant
  - 2006 – $30 per participant
  - 2007 – $31 per participant
  - 2010 – $35 per participant
  - 2013 – $42 per participant
  - 2016 – $64 per participant
  - 2017 – $69 per participant
  - 2018 – $74 per participant
  - 2019 – $80 per participant

- **Variable rate premium (underfunded plans)**
  - 1990 – $9 per $1000 ($34 per p cap)
  - 2005 – $9 per $1000 (no cap)
  - 2006 – $9 per $1000 (no cap)
  - 2007 – $9 per $1000 (no cap)
  - 2010 – $9 per $1000 (no cap)
  - 2013 – $9 per $1000 ($400 per p cap)
  - 2016 – $30 per $1000 ($500 per p cap)
  - 2017 – $34 per $1000 ($517 per p cap)
  - 2018 – $38 per $1000 ($523 per p cap)
  - 2019 – $43 per $1000 ($541 per p cap)

  Per p cap = Per participant cap

Developments
Lump Sum Window Offers

- **Lump sum windows offer terminated employees who have not yet commenced benefits (deferred vested participant) an opportunity to receive lump sum payment of their benefit**
  - **Recent background**
    - **2012 – Ford offered lump sum window to 90,000 deferred vested participants (start of recent trend) and in-pay status participants**
    - **Other large windows include GM (2012 – 42,000), TRW Automotive (2012 – 21,000), NCR (2014 – 20,000), Alcatel Lucent (2015 – 74,000)**
    - **2015 – IRS limits lump sum offers to participants in pay status (Notice 2015-49)**
  - **Variations**
    - **Limit based on benefit amount (benefit amount of $100,000 of less)**
  - **Concerns**
    - **Settlement accounting**
    - **Adverse selection (those with shortest lives take lump sum offer)**

Developments
Transfers to Insurance Companies

- **Transfers of benefits to insurance companies offer employers way to reduce or eliminate risk**
  - **Recent background**
    - **2012 – General Motors and Verizon made large transfers to insurance companies**
    - **Start of recent trend**
  - **Variations**
    - **Termination of plan and purchase of annuities through insurance company**
    - **Partial termination of plan by transferring certain benefits to insurance company**

Research

- Professor Michael Boland, Ph.D., University of Minnesota has been researching impact of defined benefit plans on cooperatives
- Next slides are result of research
- Professor Boland was assisted by Anthony Quill, M.S., student in Applied Economics, who worked on this for his thesis with Professor Boland

Research

- **Transaction between cooperatives complicated by plans**
- **Background – different retirement plan structures**
  - UBG was started by co-ops belonging to Farmland Industries
  - CPSB was started by Countrymark (co-ops in IN, OH, and MI)
  - ABC was started by Farmer Grain Dealers (later called Agri Industries in Iowa)
  - UBG, CPSB, and plans offered by MFA Oil, Southern States, and GROWMARK are multiple employer plans
  - ABC's defined benefit program is family of single employer plans (in between multiple employer plan and single employer plan)
  - Cenex and Harvest States Cooperatives (GTA) provided pension plan for local co-ops (these were converted to cash-balance plan in 1970s)
  - Co-op 401(k) is defined contribution plan

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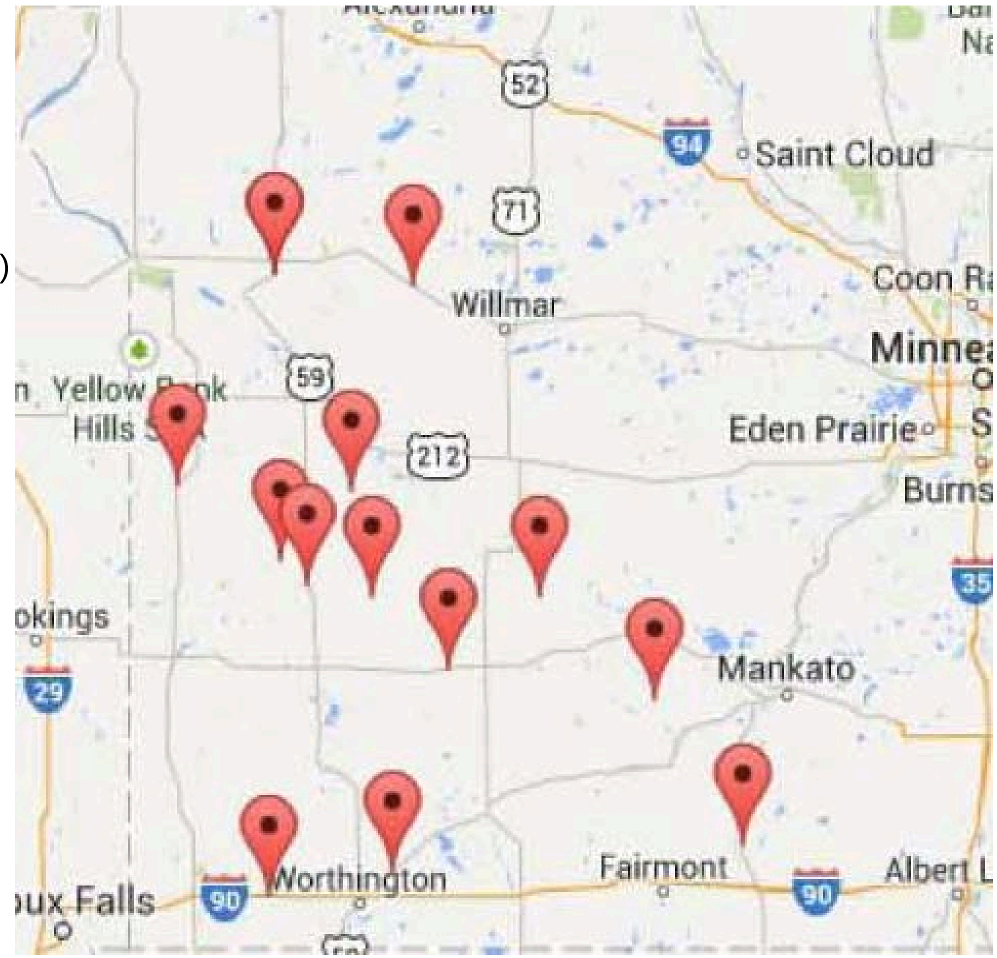
Research

- **Different cooperatives in different plans in Minnesota**
  - **UBG and ABC Co-ops: Remaining 140-odd farm supply and grain / oilseed marketing co-ops are in Co-op 401(k)**

Adrian Co-op Oil
Farmers Co-op Oil (Canby)
Lyon County (Ghent)
Farmers Co-op (Hanska)
Meadowland (Lamberton)
Prairie Pride (Marshall)
Farmers Co-op Assn (Milroy)
Farmward (Morgan)
Glacial Plains (Murdock)
Corn Plus (Winnebago)
CFS (Truman)
WestCon (Holloway)
New Vision (Brewster)
Hanley Falls

Not pictured:
Itasca County
(Grand Rapids)



Research

- **Other issues to consider**
  - Determining best type of plan to provide retirement benefit for all employees is important strategic decision with long-lasting implications for employees
  - Moving to 401(k) type program is easier to budget and gives co-op board more flexibility
    - Co-op needs to be profitable!
    - Pension costs must be considered when looking at margins, etc.
  - Employee retention has been shown to be problem
  - As more general managers get hired outside of co-op system, they lack full understanding of career paths that employees have used in past
  - Near future for increases in pension asset growth does not appear to be significant
  - Other organizations in other industries which have gotten more complex and larger in terms of employee numbers have “frozen” or considering “freezing” their defined benefit program and placed all new employees on defined contribution program
    - Are farm supply and grain marketing cooperatives getting more complex and larger?

Research

- **Exiting pension plan is not easy (nor should it be)**
  - **Challenges of managing pension plan or 401k-type plan are many**
    - **It is difficult to perfectly match market value of pension assets with pension liabilities**
    - **They are heavily regulated by government**
  - **Difficult to project future administrative costs and other fees for both types of plans**
  - **Co-ops in multiple employer plan pool risks and benefits from other co-ops in that plan**

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Research

- **What issues should board consider?**
  - **First and foremost, commitment to profitability is critical for success**
  - **Joint ventures are becoming popular**
  - **One issue is that because they are new entity, employees in that LLC can be on different benefit plan**
    - **Strategic issue is what happens if that LLC is successful enough that it leads to full merger in future or employees in that JV want to pursue career path in one of JV partners**
    - **Needs to be thought of as strategic decision and not just "what is easiest"**

Research

- **What was learned from merger of WFS (defined benefit co-op) and CVC (defined contribution co-op)?**
  - **People who are not in defined benefit plan may have negative connotations about them, and it is big hill to get over in order to get buy in**
  - **Explaining withdrawal liability is very difficult**
  - **People have hard time understanding that only way liability becomes an issue is if you withdraw, and why would you do that at historically low interest rates**
  - **Key is to get management completely educated and understanding whole concept**
  - **Difficult for board to wrap their heads completely around defined benefit plan and likely will look to management for advice**
  - **If management is uncertain, then transaction is sunk**

Challenges
Time, Resources, Risk

- **Maintaining defined benefit plan requires time and resources**
  - Plan administration time
  - Investment committee time
  - Finance time (funding projections)
  - Actuarial work and time
- **Defined benefit plan funding impacts employer's financial statements**

Challenges
Freezing Plans and Replacements

- **Freezing plan**
  - **Benefit accrual freeze**
    - **Freezes all benefit accrual factors (compensation and service)**
  - **Partial benefit accrual freeze**
    - **Freezes some benefit accrual factors (for example, service), allows others (for example, compensation) to reflect changes in subsequent years**
  - **Participation freeze**
    - **Freezes plan to new participants; existing participants continue to receive benefit accruals**

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Challenges
Freezing Plans and Replacements

- Freezing plan (continued) – Pros and cons
- Pros to freezing new participants
  - Gradual reduction in funding (if plan is underfunded)
  - Gradual reduction in PBGC premiums
  - More certain funding under 401(k) plans
  - Familiarity with 401(k) plans
  - Reduces defined benefit plan funded status volatility
- Cons to freezing new participants
  - Loss of recruiting and retention tool
  - Potential HR difficulties
  - Workforce impact
  - Ongoing costs with less or no HR benefit
  - Short-term increase in retirement plan costs
  - Requirement of at least 50 participants (or 40% of employees)
  - Potential 401(k) plan restrictions

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Challenges
Mergers and Acquisitions

- **Mergers and acquisitions**
  - **"Stock" acquisition – buyer takes over seller and continues business or merges it into buyer (buyer assumes assets and liabilities of seller)**
  - **Asset acquisition – buyer purchases assets for cash**
- **Successor liability**
  - **Stock acquisition – if seller participated in or contributed to defined benefit plan, buyer assumes liability**
  - **Asset acquisition – while normally seller would not assume liability, some courts have held that seller may assume liability with respect to certain benefits, including defined benefit plans**
    - **Courts have held that if buyer has notice of defined benefit liabilities and there is sufficient continuity of operations, buyer may be liable**
    - ***Upholsterers' International Union Pension Fund v. Artistic Furniture of Pontiac*, 920 F.2d 1,323, 1,327 (7th Cir. 1990)**
    - ***Einhorn v. M.L. Ruberton Construction Co.*, 632 F.3d 89, 99 (3rd Cir. 2011)**
    - ***Resilient Floor Covering Pension Trustees v. Michael's Floor Covering, Inc.*, 801 F.3d 1,079 (9th Cir. 2015)**

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Challenges
Withdrawal Liability

- **Withdrawal liability**
  - Multiemployer and multiple employer plans both have withdrawal liability risk
  - Risk arises in particular during business transitions and restructuring
    - Merger and acquisition, or other business restructuring
    - Disaffiliation of business (in multiple employer plan context)
    - Bankruptcy and insolvency
- **Multiemployer plans**
  - ERISA contains rules governing withdrawal liability, including with respect to seller in asset transaction
    - See 29 U.S.C. § 1381 et seq. (ERISA § 4201)
  - Multiemployer plan itself will seek withdrawal liability from employer
  - PBGC can also intervene
- **Multiple employer plans**
  - ERISA contains rules governing withdrawal liability
    - See 29 U.S.C. § 1363 (ERISA § 4063)
  - PBGC notice and possible intervention

Challenges
Facility Shut Downs

- **ERISA contains requirements with respect to underfunded plans if there is facility shut down (substantial cessation of facility at location)**
  - **Either**
    - **Employer must contribute additional amount to fund plan based on portion of workforce being terminated, or**
    - **Employer must purchase bond to protect plan with respect to amount**
  - **29 U.S.C. § 1362(e) (ERISA § 4062(e))**

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Challenges
Funded Status

- **Different measurements of plan funded status**
  - **ABO (accumulated benefit obligation) – present value of vested and non-vested benefit obligations as of present date**
  - **PBO (projected benefit obligation) – present value of vested and non-vested benefit obligations projected forward to take into account future compensation**
  - **Termination funding – funding necessary to terminate plan**
- **Funded status changes over time even in frozen plans**
  - **Assets – value of assets fluctuates and contributions affect funding**
  - **Liabilities – mortality expectations – life expectancies have continued to climb over time, increasing plan liabilities**
  - **Liabilities – interest rate changes impact liabilities**
  - **Liabilities – expense changes (increases in PBGC liabilities and other expenses)**
  - **Liabilities – potential law changes**
- **Highly technical area**
  - **Substantial consequences if funding falls below 80%**

Challenges
Funded Status

- **Termination funding status is almost always more expensive because of cost of purchasing annuities from insurance company (transfer of liabilities to insurance company)**
  - **Plans often anticipate future rate of return of 5%, 6%, or more**
  - **Insurance companies are more conservative and anticipate future rate of return of 2% to 3%**
  - **In addition, if there is lump sum option, there is potential for adverse selection (actuaries call this anti-selection bias)**
    - **Participants who do not anticipate living as long as life expectancy is projected are better off taking lump sum than an annuity**
    - **Thus, may want to avoid offering lump sum form of payment**
  - **These factors contribute to cost of terminating plan or transferring liability**
  - **There are times, however, where costs are not higher (depends on demographics, forms of payment available, and many factors)**
  - **Termination may be cheaper than continuing plan**

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