



Wespath's Role in Determining Withdrawal Liabilities

Background

The 2019 General Conference (GC 2019) approved a path for a “gracious exit” for local churches that desire to disaffiliate from The United Methodist Church (UMC). This path and associated requirements for disaffiliating local churches to follow are described in *The Book of Discipline* ¶12553. As part of these requirements, disaffiliating churches must make a withdrawal liability payment for their share of any underfunding in the UMC clergy pension plans. Wespath (a/k/a, the *General Board of Pension and Health Benefits*) must calculate annual conference funding obligations in that context. *Discipline* ¶1504.23, which was also added by GC 2019, has the same requirements. Specifically, ¶1504.23 states, “*The local church shall contribute a withdrawal liability in an amount equal to its pro rata share of any aggregate unfunded pension obligations to the annual conference. The General Board of Pension and Health Benefits shall determine the aggregate funding obligations of the annual conference using market factors similar to a commercial annuity provider, from which the annual conference will determine the local church’s share.*”

The intent of these paragraphs (¶¶12553 and 1504.23) is to safeguard the funded status of the pension plans to ensure all participants in the pension plans, regardless of whether they remain with the UMC or choose to withdraw, will receive the benefits they have been promised. The provision is not intended to be a barrier to disaffiliation, but it does reflect a connectional commitment that the disaffiliating church is making to its annual conference and fellow local churches.

Wespath's Role

Wespath has followed the requirements of ¶¶12553 and 1504.23 since their inception and regularly supplies annual conferences with their “aggregate unfunded pension obligations” (sometimes also referred to as “Allocated Underfunding”). This information is supplied at least once a year to all annual conferences and updated calculations are also available upon request to annual conferences that have determined to include more frequent updates in their disaffiliation processes. That determination is up to each annual conference.

Wespath provides funding information in its role as fiduciary and administrator of the plan and does so in a neutral and professional manner according to an established methodology in line with actuarial standards of practice. Wespath reports funding information in an objective fashion, regardless of what the results are.

We understand that depending on specific circumstances, the withdrawal liability payments can present a significant financial prerequisite to a local church’s ability to disaffiliate. We’re aware of this concern yet remain unbiased in applying required methodology.

Annual Conference Role

The important role of the annual conferences in determining an individual local church's share of the aggregate unfunded pension obligation must also be recognized. Annual conferences have adopted different approaches to this task, considering their respective local contexts. This includes considerations on financial reserves an annual conference might have available, how frequently underfunding figures are updated, whether smoothing techniques are applied (given the volatility of the Allocated Underfunding numbers), etc. Wespeth considers many such approaches to be reasonable, depending on each annual conference's unique circumstances. And importantly the Judicial Council has ruled that the annual conference has the authority and discretion to determine its procedures and requirements for local church disaffiliation.

We would suggest annual conferences exercise caution before adjusting their existing approaches in a manner that attempts to "time the market" in Allocated Underfunding values.

Recent Developments

The aggregate unfunded pension obligation is determined through an actuarial calculation. In simple terms, the results are the difference between the annual conference's allocated share of the pension plan obligations and the plan assets allocable to the annual conference. Any factor in the equation that changes obligations or assets will impact the aggregate unfunded pension obligation and hence an individual local church's withdrawal liability.

The recent changes in financial market conditions have had significant impact on the aggregate unfunded pension obligations reported by Wespeth. As of July, the aggregate underfunding is about half of what it was at the beginning of 2022. The majority of this change is attributable to rising interest rates, as we explain below.

Interest Rates

Interest rates are one such factor and an important one at that. Recent interest rate increases have not been limited to mortgage rates or bond rates. The interest rates used to determine the pension obligations have also increased significantly throughout 2022. Rising interest rates can have a material impact on pension plan obligations, with higher interest rates leading to lower obligations.

However, rising interest rates also tend to reduce the value of bonds, one type of asset held by the pension plan. At the same time, the value of equities (i.e., stocks) within the plan assets has declined just as the overall stock market has fallen on a year-to-date basis. This means that both obligations and assets have declined throughout 2022. However, obligations have declined to a larger extent, leading to the decline in underfunding over the last seven months.

Wespeth Action

With the support and advice of an independent third-party actuarial consulting firm, Wespeth has lowered the "liability premium" that is used in the determination of the pension funding obligations. From the enactment of the *Discipline* provisions until July 2022, Wespeth had been using a factor of 10% for the liability premium, which was typical of the annuity purchase market. As of July 2022, Wespeth is using a factor of 5%. This assumption change, which became effective July 1, better reflects the maturing market for pension buyouts by commercial annuity providers. This downward change in "liability premium" has further reduced the underfunding.

What Goes Down Can Go Back Up

One should keep in mind the adage “what goes up must come down” when it comes to interest rates. Wespeth has no control over the direction in which financial markets move. And while market conditions may continue to fluctuate, it would be incorrect to assume further shifts in market conditions (such as additional increases in interest rates) will automatically lead to a further reduction in Allocated Underfunding. This is because markets are driven by multiple factors, and the timing of when the market reflects those factors may be different than expected. Movement of one factor does not mean an automatic movement in a corresponding factor (e.g., Federal Reserve interest rate increases do not correspond perfectly with the bond interest rates used by actuaries to calculate pension liabilities).

However, Wespeth does regularly factor market shifts into our pension funding calculations. While market conditions so far in 2022 have caused underfunding in the pension plan to decrease, it is possible market conditions will change again and cause underfunding to increase. In fact, interest rates used to determine market liabilities are forward looking and may already have priced in future interest rate increases and decreases. And interest rates on some bonds have already started decreasing. Wespeth will continue to report the plans’ funded status based on changing market conditions.