# EXPERTS' CORNER

**Q Regulations governing annual contributions to pension plans combined with low interest rates have caused clubs with defined benefit plans to face increasing annual payments to maintain or diminish their financial liabilities. How are clubs dealing with this?**

A Over the last decade, clubs that offer a traditional defined benefit plan have seen changes in both financial reporting standards as well as modification to pension laws governing the funding of such plans. Most notable was the employer requirement to recognize the overfunded or underfunded status of the defined benefit post-retirement plan as an asset or liability in the Statement of Financial Position (Balance Sheet). A plan's funded status is measured as the difference between the projected benefit obligation and plan assets (at fair value). In addition, the Pension Protection Act of 2006 strengthened pension plans by establishing a number of rules ranging from funding requirements, interest rate assumptions used in calculating the obligation, reporting and disclosures requirements.

In addition to these two major overhauls, pension plans over the last decade have also been significantly impacted by the drop in interest rates (discount rate), which are at historically low levels and by the financial crisis of 2008, which greatly affected the equity markets. The result of these financial impacts has caused clubs to have to increase their annual contributions to the plan. The market has since rebounded; however, interest rates still remain at very low levels.

Generally speaking, each time the discount rate falls, the pension liability increases, and given the tremendous decrease in the rate, it has been the driving force for the increase in the long-term pension liability for many clubs. Congress, recognizing that this continued low interest rate environment was affecting pension plan liabilities and requiring increased contributions, passed legislation in July 2012 that provided pension funding relief and interest rate stabilization in the near term; however, it did not change the ultimate funding a club will have to pay to extinguish its liability in connection with defined benefit plans.

In a recent survey of clubs with defined benefit plans, we found 100 percent of the clubs had a deficit, with one as high as $8 million. In addition, the survey indicated that the annual contributions to maintain these plans exceeded $250,000 in approximately 40 percent of the clubs. In an effort to shore up their plans as well as diminish the financial statement impact associated with defined benefit plans, clubs have been studying a number of ways to control these pension costs ranging from "freezing" the plan to completely terminating the plan.

Typically when a club undertakes freezing a defined benefit plan, there are immediate cost savings since future benefit accruals cease. There are different ways to freeze a plan: closing the plan to new entrants while allowing those participants in the plan to continue to accrue benefits (commonly referred to as a "soft freeze") or ceasing benefit accruals for all active participants (commonly referred to as a "hard freeze"). Although freezing a plan will affect future benefit accruals, the plans still remain subject to investment volatility, interest rate fluctuations and demographic changes and remain subject to all the same funding and compliance requirements.

On the other hand, terminating a defined benefit plan, which seems very attractive, does need to conform to a standard termination process that requires the club to fully fund the plan and pay out all benefits either by lump sum distribution (if permitted) or by purchasing annuities. Because a different set of assumptions are used when purchasing annuities, the cost of annuitizing these benefits is generally much higher than fully funding a frozen plan on an ongoing basis. There are also time-sensitive administrative issues that need to be followed when terminating a plan. Generally clubs have chosen to freeze their plans versus terminating primarily due to the funding requirements necessary to terminate the plan. However, we have recently seen a number of clubs obtain bank financing to terminate their defined benefit plan. The uncertainty associated with defined benefit plans coupled with the cost and the funding requirements made their decision to obtain bank financing in this low interest rate environment very attractive. In the previously mentioned survey of clubs with defined benefit plans, approximately 60 percent have amended their plan to "freeze" the plan to reduce future obligations. For those clubs that have frozen or terminated their plans, typically a new or an enhanced 401(k) plan is offered to employees.

Determining how to handle each club's defined benefit pension plan involves complex issues and clubs would be well advised to consult with experts in this area prior to making any decisions.

*Daniel T. Condon, CPA, and Matthew P. O'Dell, CPA, are partners in the accounting firm of Condon O'Meara McGinty & Donnelly, LLP, which provides consulting, auditing and tax services to more than 325 private social clubs in 14 states. Dan and Matt can be reached at 212-661-7777. Learn more about COMD at www.comdcpa.com.*