American Academy of Actuaries

Issue Brief

Church-Sponsored Retirement Plans—Overview and Considerations

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Key Points

- Church-sponsored retirement plans may choose to be exempt from the majority of ERISA requirements.
- Exemption from ERISA requirements gives sponsors of church plans considerably more flexibility in funding and plan design than is accorded to sponsors of plans covered by ERISA.
- Exemption from ERISA requirements can create potential drawbacks for plan participants, centering primarily around transparency and benefit security.
- Actuaries, as they follow the relevant ASOPs, can help church plan sponsors understand the current and future financial status of their plans and the impact of various decisions with regard to benefit levels, actuarial assumptions and contribution policies and amounts.

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Introduction

Church-sponsored retirement plans have been around for over a hundred years in the United States and cover millions of participants. Those plans—whether defined benefit or defined contribution—are an important component of retirement security for those who are covered by and rely on them.

In a 2021 issue brief, *The Security of Pension Plan Benefits*, the Academy discussed the factors that should be considered by various stakeholders when evaluating the security of pension plan benefits. This follow-up issue brief focuses specifically on church-sponsored retirement plans ("church plans"), providing an overview of these plans and considerations for various stakeholders.

This issue brief discusses the broad range of church plans and practices. It discusses:

- The impact on a participant of being in a church plan when the ERISA protections and provisions for U.S. tax-qualified single or multiemployer pension plans generally do not apply;
- Governance and fiduciary responsibilities, including plan audit considerations;
- Differing funding sources and varying approaches to funding benefits; and
- How the bankruptcy or termination of an underfunded church plan exposes plan participants to potentially more harm than if the plan were covered by PBGC.

Background

Churches and religious organizations, like many other charitable organizations, are exempt from federal income tax under Internal Revenue Code (IRC) Section 501(c)(3). Churches also qualify for additional favorable tax treatment under the code. According to the Internal Revenue Service, this reflects Congress' recognition of unique social status and specific rights guaranteed by the First Amendment.[1]

According to a U.S. Senate report,[2] Congress exempted church plans from the *Employee Retirement Income Security Act of 1974* (ERISA) because lawmakers were concerned that the review of a church's books and records by the federal pension insurance agency created by the law "might be regarded as an unjustified invasion of the confidential relationship" between "churches and their religious activities."

In 1980, Congress made two modifications to the law that greatly expanded the number of workers covered by church plans and thus not subject to ERISA. The amendment:

- Broadened the definition of church plans to also include the employees of church-related tax-exempt organizations, such as hospitals and schools.
- Allowed certain other plans that were maintained by "church pension boards" to be treated as church plans. "Church pension boards" (now called "church benefit boards") are financial organizations associated with churches that have as their principal purpose the administration or funding of pension plans.

For a retirement plan to be a church plan, it must either be established or maintained by a church or established by an organization that is controlled by or associated with a church and maintained by a "principal purpose organization."[3] A wide variety of organizations

1 Publication 1828, Tax Guide for Churches and Religious Organizations.
2 Sen. Rep. 93-383, 93rd Cong., 2d Sess. 1974-3.
3 The church plan exemption in IRC Section 414(e)(3)(A) was amended in 1980 to read: "A plan established and maintained for its employees (or their beneficiaries) by a church or by a convention or association of churches includes a plan maintained by an organization, whether a civil law corporation or otherwise, the principal purpose or function of which is the administration or funding of a plan or program for the provision of retirement benefits or welfare benefits, or both, for the employees of a church or a convention or association of churches, if such organization is controlled by or associated with a church or a convention or association of churches."

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sponsor church plans, and thus, church plan designs vary greatly and have varying operational practices. Church plans run the gamut of size, from small single-location entities such as a Catholic Diocese or a hospital, to large denominational entities that include lay and clergy workers of the church or a multi-state health care system.

Church plans are not subject to the majority of ERISA requirements.[4] They are not required to make annual filings with the federal government, are not covered by the Pension Benefit Guaranty Corporation (PBGC), and are not required to provide certain notices to participants.[5] Church plans may irrevocably elect to be covered by ERISA, and those that do are often called "electing church plans." If they do so, they are subject to the requirements of ERISA. However, because most church plans do not elect to be covered by ERISA, often called "non-electing church plans,"[6] no comprehensive central data source regarding the number, size, or financial status of many of these plans is available.

Church plans are also exempt from many IRC rules that apply to tax-qualified plans.[7] In the absence of federal oversight and requirements, some states have enacted laws concerning church plans, which are discussed below.

Because church plans are not subject to minimum funding rules, plan sponsors have significantly more flexibility in deciding on funding approaches. Very often, sponsors may ask their actuarial advisers for assistance in developing these policies. Actuaries may also be asked by decision-makers to provide information to assist with plan design and administration decisions. Actuarial standards of practice (ASOPs) provide a framework that actuaries working with church pension plans (or any plan) may reference to assist with their work. Selected ASOPs that church plan actuaries may find particularly relevant are discussed in the appendix.

The definition of a church plan and which types of organizations may sponsor these plans is beyond the scope of this issue brief.

4 Church plans as defined in Internal Revenue Code Section 414(e) and in ERISA Section 3 (33) are exempt from most ERISA requirements per ERISA §4(b)(2).
5 Other types of plans, such as those sponsored by state and local governments, are also exempt from ERISA. While those plans are similar to church plans in some ways, such as the absence of PBGC coverage, they are different in other ways, such as the funding sources available for the plans.
6 The term "church plan" in this issue brief refers to "non-electing church plans" unless indicated otherwise.
7 "Issue Snapshot—Qualification Requirements for Non-Electing Church Plans under IRC Section 401(a)"; Internal Revenue Service; Aug. 18, 2023.

Two Types of Church Plan Sponsors

The two types of church plan sponsors are a Qualified Church Controlled Organization (QCCO) and a Non-Qualified Church Controlled Organization (Non-QCCO). According to Servant Solutions:[8] "Examples of QCCOs are seminaries and General Assembly agencies and entities. Churches, and church-related primary and secondary schools, though not technically QCCOs, have to follow the same rules as QCCOs. … Examples of non-QCCOs are church-affiliated hospitals, universities, children's homes, and retirement housing facilities."

Non-QCCOs, like QCCOs and churches, are qualified to participate in church plans. However, non-QCCOs must comply with the universal availability requirement and the nondiscrimination requirements of IRC sections 401(a)(4), 401(m), and 410(b). These requirements are not applicable to churches and QCCOs.

Participant Considerations

A sponsor of a plan with church plan status has considerably more flexibility than a sponsor of a plan covered by ERISA. The church plan sponsor has more discretion regarding funding approaches, plan design, and the ability to change the plan's provisions. The exemption from PBGC coverage and the associated annual premiums can make plan sponsorship more appealing to qualified sponsors. This additional operational flexibility, which can support the continued sponsorship of these plans, may result in both positive aspects as well as drawbacks for church plan participants.

Positive Aspects

- Less regulation can lower overhead costs—making the plan more affordable, efficient, and sustainable.
- Because the IRS nondiscrimination rules generally don't apply, benefit levels can be efficiently targeted to meet the needs of specific employee groups.[9]
- Hybrid plans with both defined contribution and defined benefit features can be implemented, allowing financial stability for participants.
- Plans can more easily incorporate portability for participants who may move from one entity to another entity within the plan or to a separate plan.
- Payout options that provide more flexibility than is typically available in ERISA plans may be available.
- Funding flexibility can allow plan sponsors to defer funding in difficult times, allowing the plan to be maintained in the long term.

8 QCCO vs. Non-QCCO; Servant Solutions; 2020.

9 IRS Notice 2001-46 provides that nonelecting church plans are not subject to various nondiscrimination regulations until further notice—and such notice has not yet been provided. In the meantime, such plans are subject to a good faith standard of complying with the statutory nondiscrimination requirements.

Drawbacks

The lack of a compliance requirement for ERISA/IRS regulations can also create drawbacks for participants. These potential drawbacks center primarily around transparency and benefit security:

- Participants may receive little, if any, communication about their plan's funded status (no required annual funding notices or Form 5500s) and benefits, rights, and options (no required summary plan descriptions or summary of material modifications).
- Spousal benefit protections are not required. While some sponsors equal or exceed ERISA-style requirements, others do not.
- In the absence of funding requirements, benefits may be poorly funded, which in turn can lead sponsors to reduce or eliminate them to mitigate the underfunding.
- Unfunded benefits are typically not protected in the case of bankruptcy or other organizational change.
- The inapplicability, to date, of the IRS nondiscrimination rules may result in greater disparity of benefits between different subsets of the employee population.
- Eligibility and vesting periods may be longer than those required by ERISA.
- Lump sum cash-outs of benefits can be offered at lower levels than minimums determined using IRC-mandated assumptions.
- In the absence of federal plan audit requirements, there may be little to no outside oversight of plans whose sponsors do not voluntarily choose to have an audit, and might open the door for bad actors, mistakes, or mismanagement.
- Participants are not protected from sponsor-directed changes to the plan, including reduction of accrued benefits.
- Although church plans are covered by the missing participant rules, a lack of internal resources and poor recordkeeping among some plans could limit such plans' sponsors' ability to conduct robust searches.

Churches' particular cultures may encourage employees to place trust and reliance on their employer for promised total compensation packages. That reliance has been well rewarded for many but can expose the employees to risks not shared by their counterparts covered by an ERISA plan.

Plan Governance

Making and implementing good decisions is essential for all retirement plans, regardless of whether they are subject to ERISA. Good governance is essential for retirement plans to be successful. It requires balancing the needs of various stakeholder groups as well as overseeing significant administrative and investment functions.

Implications for Church Plans

Despite the reduced federal oversight, church plans do operate within a legal environment. Fiduciary responsibilities for church plans are summarized in this article. Participants in church plans have various state law remedies available to them, such as breach of contract. Breach of contract is seen as the most viable remedy due to the employer's promise to maintain a pension plan in exchange for the employee's service. On a broader scale, some states have implemented other requirements, such as audits and other reporting for plans that are domiciled there. As ERISA exempts church plans from state-law preemption, states have the ability to create legislation that places affirmative duties on church plan sponsors. For example, Rhode Island enacted a law in 2019 that requires certain employers that sponsor church plans to provide participating employees an annual report about the plan's funding.

Regardless of the legal environment, strong governance matters. Many church plans are very well-managed and -governed and generally follow most provisions of ERISA. Many larger sponsors employ professional internal staff (some employ in-house actuaries), retain outside experts, and form governing boards or committees to provide oversight and direction. These plans have dedicated assets held in trusts and investment committees that oversee how those assets are invested. However, in some cases, insufficient governance has led to an inability to meet all benefit obligations. For example, some church-related hospitals have been unable to pay all the benefits owed to participants.[10]

Plan Funding

Having an established funding policy provides several advantages. It:

- Provides a systematic approach to fund the plan over time;
- Helps provide confidence that promised benefits can be paid when they come due;
- Provides the ability to budget for projected contributions;
- Allows plan design to be aligned with budgetary constraints; and
- Provides a framework for ongoing monitoring of funding progress.

In general, defined benefit plans subject to ERISA have a legal minimum annual contribution based on prescribed mortality and interest assumptions. These requirements provide a minimum funding policy framework for these plans.

However, as noted above, church plans are not subject to the minimum funding rules under ERISA that apply to single-employer and multiemployer plans, nor are they required to use any prescribed actuarial assumptions (such as mortality and interest)

10 "They worked at a Catholic hospital for decades. Then it took away their pension"; CNBC; Feb. 13, 2020.

when calculating their funding liabilities. Without these regulatory requirements, a wide array of practices have evolved regarding the determination and transmission of contributions among church plans.

Though not required by ERISA to perform actuarial valuations, many church plans have a policy of making contributions as calculated by an actuary. Many of these plans calculate their liabilities and associated contribution amounts based on actuarial methods and assumptions that differ from those required for single-employer plans under ERISA. These alternate approaches include:

- The use of a policy to determine the contribution (for example, fund normal cost (the cost of benefits earned in the year) plus unfunded liability over X number of years)
- The use of a different approach to determining interest rates[11]

Some plans don't calculate an actuarial contribution. Instead, they determine the funded status of the plan and adjust benefits as appropriate to maintain the financial health of the plan.

The funding challenges facing a particular church plan often depend on the nature of the sponsoring organization. Some organizations that are primarily dependent upon voluntary contributions (e.g., smaller traditional churches) may have limited ability to absorb contribution volatility. However, some organizations that are primarily fee-based organizations (e.g., some hospitals) may be better able to absorb contribution fluctuations. Intergenerational equity may also be an issue, depending on the sources of funding dollars and the ratio of active to retired participants.

As mentioned above, the interaction of benefit policy with the plan's funded status is another feature of some church plans. Some plans may have a fixed contribution rate but will review the benefit level on an annual basis and adjust the benefit based on the plan's funded status and/or projected funded status. This concept is similar to a variable annuity plan without the regulatory constraints that apply to ERISA variable annuity plans. The flexibility that church plans enjoy allows these plans to consider the long-term financial health of the plan in determining the benefit adjustment. While these plans do not calculate an actuarially determined contribution, their approach to managing the long-term financial health of their plan may be more sophisticated than some of the plans that calculate and contribute an actuarially determined contribution amount. The result is a high likelihood of maintaining the financial viability of the plan.

11 ERISA requires single-employer plans to use the unit credit cost method and corporate bond rates for discounting future benefit obligations. ERISA requires multiemployer plans to use the expected rate of return on plan assets for discounting future benefit obligations. Actuaries for church plans use both the single-employer and multiemployer approaches for determining church plan contributions.

As a result of the wide array of practices, some church plans are well-funded, or have implemented a contribution approach that will result in becoming well-funded. However, other plans have struggled to fully fund the benefits being promised and, in some cases, have had to reduce benefits already earned.

Plan Termination/Insolvency/Bankruptcy

Organizations that sponsor plans can find themselves financially unable to fund the plan or continue their plan sponsorship. The sources used to fund the plan may change or be reduced or the sponsors may undergo bankruptcy proceedings. Because church plans are not covered by the PBGC, participants in a terminating church plan have no guarantee that they will receive all—or even any minimum part—of their benefits. Also, church plans are exempt from the anti-cutback provisions in ERISA, which makes participants vulnerable to having benefits that they have already earned being reduced—even after they have retired and started receiving monthly payments. The lack of anti-cutback protection can create cases where church plan sponsors elect to reduce the benefits payable to participants to make the plan more affordable. In an ongoing plan, benefits might be restored if the plan's financial status improves. However, terminating a church plan with insufficient assets to pay all benefits will likely result in permanent benefit cutbacks.[12]

In contrast, private-sector plans covered by the PBGC can only voluntarily terminate after first paying all benefits, either by purchasing an annuity contract from a highly rated insurer or paying a lump sum subject to IRC-mandated minimum assumptions instead of the future annuity benefits. The PBGC may also take over a plan of a financially distressed company. When it takes over a plan, PBGC pays benefits up to its maximum guaranteed amounts set by law and updated each year.[13]

Because church plan participants do not have the protections under ERISA, they must pursue state law remedies when plan sponsors fail to meet pension obligations. State law protections are typically much less robust than ERISA's protections. Also, state law remedies are generally available only after a sponsor fails to provide the promised benefits. By the time a plan misses payments to retirees, the sponsor may have few assets left. In such cases, it may be too late for the participants to have a meaningful chance for recourse.

12 One example is St. Clare's Hospital of Schenectady, NY, which terminated its underfunded pension plan in 2018, resulting in the reduction or elimination of participant benefits. See "Church Plan Litigation—Out of the ERISA Woods Into the State Law Forest"; Groom Law Group; Dec. 29, 2021.

13 For 2024, the maximum guarantee for single-employer plans is $7,107.95 per month, or $85,295.40 per year, for a 65-year-old retiree with no survivor benefit. The maximum guarantee for multiemployer plans is $429 per year of service (e.g., $12,870 for a participant with 30 years of service) and is not subject to adjustments for inflation.

Summary

Making generalized statements that apply to all church plans is difficult because the absence of regulatory constraints has enabled these plans to vary as much as the sponsoring organizations themselves, which encompass many different faiths and structures. Some plans are designed and operationally run as if they were covered by ERISA. But many others leverage their ERISA exemptions such that participants may receive less information about their benefits, may participate in plans that are less well funded, may experience reductions in benefits and may have choices of forms of payment that are not actuarially equivalent.

There is an uneasy balance between having this flexibility, which may enable initial/continuing plan sponsorship, and having an operating/funding structure that may put participants more at risk of not receiving their full benefits. Also, plan participants who are trying to plan for retirement by determining how much they need to save and when they can afford to retire are best served by receiving annual communication about their benefits and robust information about benefit choices at retirement.

Congress had taken note of recent bankruptcies where church plan participants lost their retirement benefits when it asked the Government Accountability Office (GAO) to provide more information on the prevalence and provisions of these plans. The GAO issued its report in September 2023. Some states have noted a vacuum in the absence of ERISA requirements for church plans and enacted requirements of their own. Regulatory guidance for church plans could be undergoing more scrutiny in the future.

Workers who are comparing choices in employment between organizations with church plans and organizations with ERISA-covered plans would benefit from a greater understanding of how the differences in these programs could affect them.

Actuaries, as they follow the relevant ASOPs, can help church plan sponsors understand the financial status of their plans and the impact of various decisions with regard to benefit levels, actuarial assumptions, and contribution policies and amounts both currently and into the future.

Appendix

Responsibilities of Actuaries/ASOPs

Actuaries look to the Code of Professional Conduct (Code) and ASOPs for guidance on their responsibilities with regard to the actuarial services they deliver to church plans. Some ASOPs are general in nature and apply to all actuaries, and some ASOPs are practice-specific and apply to actuaries providing actuarial services to pension plans. When an external consulting actuary is engaged to perform valuation or plan design pricing work, their work is not to make funding, plan design or administration decisions on behalf of the plan. However, in that situation, the actuary is often asked by decision-makers to provide information to assist with those decisions. Other plan sponsors may have internal actuaries serving either as the plan actuary or in some other management or governance role, who do make such decisions. Some of the guidance that actuaries working with church pension plans may reference to assist with their work are detailed below.

- The Code provides guidance regarding communications of actuarial work product and taking reasonable steps to avoid the misuse of that work product.
- ASOP No. 41, *Actuarial Communications*, provides additional, more specific, guidance regarding actuarial communications.
- ASOP No. 4, *Measuring Pension Obligations and Determining Pension Plan Costs or Contributions*, provides guidance on measuring pension obligations and determining pension plan costs or contributions. Notably, the revisions to ASOP No. 4, effective in February 2023, require disclosure of a "Low-Default-Risk Obligation" and "provide commentary to help the intended user understand the significance of the low-default-risk obligation measure with respect to the funded status of the plan, plan contributions, and the security of participant benefits." This liability measure may be different than the liability measure requested by the plan sponsor for other purposes. The ASOP also requires disclosure of a "Reasonable Actuarially Determined Contribution." This calculation may provide an alternative contribution amount to the contribution calculation requested by the plan's sponsor and provide the plan sponsor with more information regarding plan funding options. Section 3.19 of ASOP No. 4 also requires that the actuary "qualitatively assess the implications of the … plan's funding policy" and disclose whether the "funding policy is significantly inconsistent with the plan accumulating assets to make benefit payments when due."
- When pension liabilities are being measured, ASOP Nos. 27, *Selection of Economic Assumptions for Measuring Pension Obligations,* and 35, *Selection of Demographic and Other Noneconomic Assumptions for Measuring Pension Obligations,* provide guidance on the selection of economic and demographic assumptions, respectively.

Even if the assumptions are prescribed by a third party, the guidance indicates that the responsibility remains to "assess the reasonableness of each … assumption" and disclose "any such assumptions that significantly conflicts with what, in the actuary's professional judgment, is reasonable for the purpose of the measurement." In addition, ASOP No. 4 requires that "the actuary should assess whether the combined effect of assumptions is expected to have no significant bias."

- ASOP No. 51, *Assessment and Disclosure of Risk Associated with Measuring Pension Obligations and Determining Pension Plan Contributions,* provides guidance on assessing risk for pension plans. In conjunction with a funding valuation or plan design (pricing) exercise, the actuary is required to disclose a qualitative assessment of the "risks that, in the actuary's professional judgment, may reasonably be anticipated to significantly affect the plan's future financial condition." The guidance also indicates that "a more detailed assessment" is recommended if the actuary believes it "would be significantly beneficial for the intended user to understand the risks." Maturity metrics and historical information required to be disclosed as a part of this assessment may be helpful for plan sponsors in understanding the plan's risks. Importantly, ASOP No. 51 "does not require the actuary to evaluate the ability or willingness of the plan sponsor or other contributing entity to make contributions to the plan when due," but if the actuary has "indications that the plan sponsor or other contributing entity may not make current or future recommended contributions to the plan," that risk is included in the disclosure.

The framework of the Code of Professional Conduct and ASOPs helps to define the actuary's role and provides direction regarding the information that should be provided to plan sponsors to make funding and plan design decisions for church plans. Due to the range of practices available to church plans and limited regulatory framework, consistent interaction and communication among all of a plan's service providers (actuaries/auditors/investment advisers/lawyers) can be even more important when working with church plans.

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