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Willis Towers Watson stakes its claim to $150bn gov. contracts pension market

Government contractors are more likely to have defined benefit plans and to need specialized retirement consulting than other large companies.

Dietrich Knauth | 05 Apr 2018

Willis Towers Watson (WTW) is looking to corner the market on consulting services for government contractor pension plans, bringing on two experts that have decades of specialized experience in that space.

Seeking to capitalize on an existing strength, WTW recently hired **John McQuade** and **Deborah Tully**, formerly of **Pinecliff Consulting**, as senior members of the company's government contractor industry group. Both specialize in the unique accounting regulations that government contractors need to follow, consulting on benefits and financial strategy, and negotiating contracts and resolving disputes related to pension accounting. Their knowledge will expand WTW's capabilities and deepen an already-strong practice area, according to **Bill Gulliver**, head of the firm's North America retirement business.

Government contractors are an attractive industry segment for pension consultants, because they are more likely to have pension plans than most other private companies, and because they often need specialized

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assistance to navigate the regulations that determine how much the federal government will contribute into those pensions, Gulliver said. Contractors invest their pension assets much like other corporate plans, but they tend to be more conservative in their strategies.

"The government contractor group is one of the sectors where defined benefit plans continue to be an important part of the reward strategy for many of those clients," Gulliver said. "That's why we've spent a lot of time and effort building significant capabilities in that space."

Cornering the market

WTW has a 200-person industry group team, including 35 actuarial consultants, that focus on the needs of government contractors, which collectively received $510bn in federal dollars in 2017, according to Bloomberg data. WTW provides retirement services to over 100 clients that focus on government contracts, it serves as actuary to 20 large government contractors, and it works with all ten of the largest government contractors, which had more than $150bn in combined pension assets in 2016, Gulliver said.

Pinecliff and WTW shared many clients, and had worked together on issues facing those clients in the past, and the consulting firm saw an opportunity to bring their skills to a larger pool of clients while sharpening its focus on contract negotiations and resolving disputes, areas where Willis Towers did not have a lot of strength and depth, Gulliver said.

McQuade and Tully called the move to WTW an "obvious fit." McQuade said that Pinecliff and with WTW were two of the only firms performing specialized retirement and actuarial services for government contractors, so joining forces made for a particularly strong team.

"WTW had a critical mass of existing government contract clients, which made them attractive from our perspective," McQuade said.

Unique challenges

While government contractors face the same ERISA rules as other companies with defined benefit plans, they have an additional layer of regulations specific to their industry.

"The pension plans themselves, in terms of paying benefits to retirees, aren't especially unique," McQuade said. "What is unusual is if you're a commercial company, you have to comply with ERISA funding rules, you have to comply with financial accounting rules."

The government contributes to contractor pensions as indirect costs that can be spread across multiple contracts for noncommercial items – like a military jet fighter. The Cost Accounting Standards determine how pension costs are allocated to government contracts, and they require separate calculations from ERISA, because they use different actuarial assumptions. The conflicting discount rates can lead to apparent anomalies, like a plan that is overfunded on a CAS basis, but underfunded on an ERISA basis, which could require a company to reimburse the government for pension settlement costs even for an underfunded plan, according to a 2013 **Government Accountability Office** report on the topic.

Ripe for disputes

In addition to the day-to-day difficulty of managing an extra layer of actuarial calculations, the shared responsibility for contractor employee pensions creates many opportunities for conflict, especially at moments when a pension plan is frozen, curtailed, closed, or transferred. At those moments, the government and the contractor must calculate their liabilities, using the different discount rates under ERISA and CAS, and settle their respective pension costs after years of estimated payments.

Sometimes the government will owe additional money, and sometimes the contractor will, and disputes over who owes what can be incredibly damaging to a company's cash flow, McQuade said.

"If the government paid too much, you can't take that out of the pension plan, it would have to come out of the company treasury," McQuade said. "There's a real incentive for contractors to avoid these disputes and if they arise, to resolve them as rapidly as possible, because even if they're right, they can lose substantial amounts of money."

The disputes rarely impact the funded status of the plans themselves, however, since the companies must follow ERISA funding rules even when the government's contributions are in dispute, McQuade said. Contractor pensions tend to be invested in similar ways to other large corporate pension plans, although the GAO found that contractors tended to favor more conservative strategies and have a higher allocation to fixed income investments.

Tully and McQuade believe that settling of pension liabilities will be an active area of focus in the months ahead. Contractors – like other companies with defined benefit plans – are increasingly freezing their pension plans, or transferring the risk to buyers like insurance companies, both of which require a settling of costs with the government. Merger and acquisition activity can also trigger "true up" of pension costs if a business unit with a defined benefit plan is sold or transferred.

"This true up concept is now presenting itself more and more as companies are spinning off business units or as companies are freezing their pension plans," Tully said. "There is a litigation risk looming. This is very much a developing area that the government and contractors are trying to navigate."

Consultant Profile

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