BCG Retirement News Roundup

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Boomershine Consulting Group (BCG) has launched this monthly news roundup of highlighted significant articles from the retirement industry – for clients and friends. Retirement plan news has become increasingly pertinent for many audiences these days, including:

- Retirement Plan Sponsors – addressing both private and public sector issues
- Employers – dealing with complicated decision making for their plans
- Employees – educating the Boomer generation that is nearing retirement
- Industry Practitioners - helping to understand and resolve today's significant challenges

We review numerous industry news services daily and will include a collection of timely and significant articles each month concerning compliance, actuarial plan costs (including assumption debates), plan design change issues and benefit trends, as well as other related topics.

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Public Sector/Government Plans

Senate OKs 401(k)-style pension plans for state employees

A controversial plan to let future state employees opt into a 401(k) style pension plans – instead of fixed-payment pensions that most receive today – won passage in the state Senate by a narrow vote of 25 to 22 on Thursday.

Senate Bill 5851 also lets existing members in state-run Plans 2 and 3 to make an irrevocable switch into the new option – dubbed the Public Employee Savings Plan – in early 2015.

Republican Sen. Pam Roach of Auburn was among those voting for the bill. But Roach first won passage of an amendment to let new state employees that opt for the 401(k)-style option to later revert or buy their way into the fixed-benefit plans that would remain available.

Sen. Barbara Bailey, R-Oak Harbor, is prime sponsor of the bill, which is a milder approach than Senate Majority leader Rodney Tom's proposal to force all new hires into 401(k) plans after mid-2014.

"Many people across the country are now going to these plans because they do offer choice. They do offer flexibility,'' Bailey said in a floor speech supporting her legislation.

The Washington Federation of State Employees has been hostile to either proposal to tinker with pensions, arguing the plans are cost effective and not in need of change. The union's leaders also believe Bailey's amended plan would dilute assets in the existing second-generation retirement plans that offer fixed benefits in retirement.

New state workers already have a choice of entering into a hybrid pension – Plan 3 – that is one-half fixed benefit, one-half 401(k).

Federation spokesman Tim Welch said Roach's amendment was an attempt to reduce the bill's harm to workers. "But still the bill overall is a bad bill. I don't think there is any way you can dress it up," Welch said. "We believe that it will undermine the current successful retirement system that we have …"

State Treasurer Jim McIntire, a Democrat, also has voiced opposition to the plan while touting the benefits, low cost and efficiency of the existing system.

The bill got the bare minimum of votes for passage and it faces skepticism, if not opposition, in the Democrat-controlled House. In the run-up to the vote, Democratic Sen. Karen Fraser of Thurston County spoke against it. And Democratic Sen. Steve Conway of Tacoma offered an amendment requiring the whole idea to be studied by the Legislature's Select Committee on Pension Policy.

The study would have looked at the financial impact on existing pension plans and on contribution rates for state employees and both state and local governments. Some pension experts say the mobility of cash invested in the 401(k) style plans would reduce the State Investment Board's ability to invest large blocks of pension money for long periods in private equities – which the SIB has used to generate high returns in excess of 8 percent a year, on average, over two decades.

The vote roll call is here. Only one member of the minority Democratic Caucus voted in favor of the bill. That was Sen. Jim Hargrove of Hoquiam who has been casting votes on behalf of ailing Republican Sen. Mike Carrell of Lakewood. Two Democrats who are part of the Republican-dominated Senate Majority Coalition – Sen. Tom of Medina and Sen. Tim Sheldon of Potlatch – also voted for the measure.

As the bill moves to the House, it is shaping up as a possible bargaining chip in the ongoing Senate-House budget talks. Lawmakers say they are working toward finishing work Sunday, the last day of a 105-day regular session, but few believe they'll get done – meaning there could be a prolonged period of time to consider the measure.

Read more here: http://www.theolympian.com/2013/04/26/2521620/senate-oks-401k-style-pension.html#storylink=cpy

Brad Shannon | Staff writer • Published April 26, 2013

Has Pension Reform Gone Too Far?

Nearly every state in the union and scores of localities have reacted in recent years to their growing unfunded public pension liabilities with reforms that aim to soften that financial burden in the coming decades. The changes have ranged from reducing benefits for current retirees to raising the retirement age to establishing new (read: cheaper) plans for incoming public employees.

But have some of these reforms gone too far? Might governments now be putting themselves in a position where they can no longer attract the best person for the job?

"Plans have actually done a lot," Alicia Munnell, director of the Center for Retirement Research, said at the Future of Retirement Summit this week in Washington, D.C. "And in some cases, in my view, they've done too much."

Munnell and others noted that, if the cuts states and localities made to their pension plans hold, the cost to governments will certainly be less in the future. But those cuts are "not a costless thing to do," Munnell said. The center's research has consistently shown that compensation in the public sector and compensation in the private sector have been roughly comparable because more generous benefits packages for public workers tend to make up for lower pay. But when governments start cutting benefits, private-sector jobs gain the edge.

“So when you start cutting back on pension benefits, without thinking of them in terms of total compensation package, you risk ending up with a compensation system that falls short of what’s happening in the private sector,” Munnell said. "It has to be recognized that these [pensions] are just one part of compensation and when you do this you have to think of the whole package.”

Indeed, the notion is on governments' radar as employee retention is one of the top concerns for public employers, according to a recent survey by the Center for State and Local Government Excellence (SLGE), which hosted the retirement summit. Among the governments surveyed by SLGE, 70 percent said that staff retention and development were important issues looking ahead.

What's exacerbating that retention issue is a poor opinion of government workers, said Joshua Franzel, SLGE’s vice president of research. “What often comes up as being a persistent problem is the public perception of workers,” he said, “and how that impacts those that otherwise might stay in public service but instead choose to retire.”

Franzel noted that as localities have rebounded from the Recession, his research has shown an uptick in the number of retirements in the state and local sector. The public worker perception has been a contributing factor to that, as has the notion from workers that they should retire before their employer changes their benefits on them, Franzel said.

That environment can make it difficult to attract the best talent for those positions as they open. Munnell noted one of her center’s studies looked at how cutbacks could affect the quality of teachers that school systems were able to attract. The study used the average SAT score at teachers’ undergraduate institutions as a measurement for teacher quality and related that to wages and benefits paid at their respective school districts. The result? “You just got teachers from higher quality schools if you paid more,” Munnell said, adding that the example can be extrapolated across most government jobs.

“All the teacher slots, all the public employee slots will be filled,” she said. “But they will be filled with less competent people than you would have had otherwise if you keep compensation equal between two sectors.”

Certainly, municipalities are working on ways to attract the best and brightest by offering other perks. In Montgomery County, Maryland, Human Resources Director Joseph Adler said the county offers a highly competitive management development program in coordination with Johns Hopkins University and a deferred retirement option (DROP) program as recruitment tools. The county is also “looking at” flexible work hours and teleworking for some employees, but those perks can bring challenges.

“There’s a tremendous amount of resistance to telework from middle level managers who believe that the employees who want to telework are going to be goofing off, running around in their pajamas and flip flops and they’re not going to be working," Adler said. A second “path of resistance” he added, is jealousy from employees like bus drivers or receptionists who, by nature of their jobs, can’t telework.

Still, he said, the brain drain that some managers worried about hasn’t come to fruition, he said, and it’s giving the county time to thoughtfully approach recruitment and retention.

“Several years ago, it was every single baby boomer, the minute they hit 62, they’re going to walk out on you. That has not happened,” said Adler, a veteran of state and local human resources. “They’re still there – I’m still there.”

Posted By Liz Farmer | April 19, 2013

Governor’s Proposal to Delay State Contributions Would Add Billions to Public Pension Debt

HARRISBURG, PA (April 16, 2013)—Delaying state and school district pension contributions, as Governor Corbett has proposed doing, would worsen Pennsylvania’s public pension debt, according to the fourth in a series of “Pension Primers” released today by the Keystone Research Center (KRC).

Despite referring to this approach as “kicking the proverbial can down the road,” the Corbett administration’s own analysis shows that reduced pension payments between now and 2019 will increase Pennsylvania’s pension debt by nearly $5 billion over the period.

“Never has Ronald Reagan’s famous statement ‘There You Go Again’ seemed so apropos,” said Dr. Stephen Herzenberg, KRC’s executive director and an economist who authored the pension primer. “Everyone including the Governor recognizes that short-sighted delays in employer pension contributions is a big part of how Pennsylvania ran up its current pension debt.”

KRC released the latest primer in conjunction with testimony delivered by Dr. Herzenberg at the Pennsylvania House State Government’s hearing on public pensions today. The hearings represent an early step in the Legislature’s deliberation over pensions since the Governor’s sweeping pension proposal released in his annual budget address in February.

In his testimony, Dr. Herzenberg reviewed key points from three KRC pension primers released in February and March, which highlighted other ways the Governor’s proposal would increase Pennsylvania’s pension debt and the cost of pensions for new employees.

“The Governor’s pension proposal has a serious case of pension deficit disorder,” said Dr. Herzenberg, noting that Pennsylvania Treasurer Rob McCord has estimated that the Governor’s plan could increase Pennsylvania’s pension debt by $25 billion by 2016.

The latest pension primer assesses employer and employee contributions to Pennsylvania’s defined benefit pension funds since 2001, and the Governor’s proposal to reduce employer contributions going forward. It compares high employee and low employer contributions to the State Employment Retirement System (SERS) and the Public School Employee Retirement System (PSERS) since 2001.

Over the crucial period from 2001 to 2009 when Pennsylvania began to run up a large pension debt, employees contributed an average of 6.7% of their salaries to their pensions, while in some years the state and school district employers contributed nothing. During this period, Pennsylvania employees contributed nearly twice as much to statewide pension funds as employers, according to U.S. Census data. Nationally, public employers provided nearly twice as much funding to state pension plans as employees during this period.

Altogether, the ratio of Pennsylvania employee-to-employer pension contribution from 2001 to 2009 equaled nearly 3.5 times that of the rest of the country. If Pennsylvania and its school districts had contributed as much as the public employers’ national average toward pensions since 2011 (assuming employee contributions remained the same), SERS and PSERS would now have upwards of $20 billion more, counting investment returns from higher contributions. That would have allowed Pennsylvania to reduce its pension debt by more than half.

In his House testimony, Dr. Herzenberg provided a comprehensive analysis of the Governor’s proposal and more incremental proposals to shift state and school employees into defined contribution pensions. This included a review of KRC’s earlier pension primers.

- The first primer, Digging a Deeper Pension Hole, pointed out that closing the state’s defined benefit pensions to new employees will reduce the plans’ investment earnings. With new member contributions no longer flowing into the plans’ asset pool and remaining plan members aging and retiring as a group, pension plan managers will be forced to invest in less risky and more liquid assets. Studies in a dozen other states agree that a closed defined benefit plan loses investment earnings and increases taxpayer costs for meeting pension commitments to current workers and retirees. Experience in the three states that have closed defined benefit plans—Alaska, Michigan, and West Virginia—also show negative impacts for taxpayers, retirees or both.

- The second primer, Paying More for Less, estimated the increase in cost for pensions of new employees at $189 million once the Governor’s proposal is fully phased in and all employees are enrolled in a 401(k)-like plan, with $112 million of this cost falling on the backs of school districts and local property taxpayers.

- The third primer, Long-term Savings in 2010 Pension Reform Law Hard to Beat, documented the pension savings for new employees as a result of the Pension Reform Act of 2010. It also highlighted a unique shared risk feature of the 2010 law, which will increase employee contributions up to 2% in the event that financial markets fall short of investment returns projected by SERS and PSERS (currently 7.5%). This shared risk feature is wisely conditioned on employers also maintaining or increasing contributions if financial markets plunge.

“Act 120’s shared risk feature is well designed to avoid exactly the kind of shortsighted decisions that reduced employer funding for pensions starting in 2001 and throughout a period of time that required more robust contributions,” said Dr. Herzenberg.

Keystone Research Center
April 16, 2013

Maryland governor gets bill changing pension funding formula

The Maryland General Assembly passed a bill that will require the state to pay the actuarially required contribution to the $40.2 billion Maryland State Retirement & Pension System, Annapolis.

The bill, which passed last week and is being sent to the governor, would be phased in over the next 10 years to replace the current “corridor method” of funding the pension system.

Under the corridor method that was adopted in 2002, the state can contribute the same amount as prior years as long as the funded status remained between 90% and 110%. If the funded status were to dip under 90%, the contribution rate would be set at the rate in effect for the previous year plus 20% of the difference between the ARC and the previous year's rate.

The bill also eliminates a tiered amortization period and replaces it with a closed, 25-year amortization.

"The Legislature has taken a very important step in eliminating a funding method that has contributed to an underfunding of the system," Nancy K. Kopp, state treasurer and chair of the pension system board of trustees, said in a statement. “The pension reforms that the General Assembly enacted two years ago are on course to lead us to our goal of a fully funded system, and this additional reform of the state funding policy will help sustain it in the long term."

The bill would take effect July 1, which means the June 30 valuation will be used to calculate the fiscal year 2015 contribution. Under the bill, the state would contribute about $19 million less in fiscal year 2015. Starting in fiscal year 2024, the new bill would save the state $450 million once the corridor method is completely phased out. The pension system is expected to be 80% funded by 2025, said spokesman Michael Golden, in an e-mail.

The funded status of the six pension funds in the system was a combined 64.4% as of June 30. Only the $329 million judges' pension fund was more than 70% funded, at 78.4%.

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Private Sector

Cash Balance Plans Could Overtake 401(k)s

April 19, 2013 (PLANSPONSOR.com) – Cash balance plans are growing in popularity and could overtake 401(k) retirement plans within the next few years, according to research from Sage Advisory Services.

The Texas-based investment management firm recently released research that cites figures from the U.S. Department of Labor, which illustrate the rise in popularity of cash balance plans. In 2001, there were less than 1,500 such plans. By 2010, there were more than 7,500—an average growth rate of around 20%.

Sage’s findings also show many mid-size and small businesses are seeing the advantages of such plans (e.g., flexibility, transparency, employee satisfaction).

“Fedex, Coca-Cola and Dow Chemical have or have had cash balance plans,” Alex Pekker, co-author of the research and a vice president with Sage, told PLANSPONSOR. “With the larger firms it can be tied in with the presence of large unions. With our research, we have seen more mid-size companies (such as high-tech firms and law firms) and smaller companies (such as medical offices) express interest in having a cash balance plan.”

One of the big advantages is that they let more money be contributed, Meghan Elwell, co-author of the research and a vice president with Sage, told PLANSPONSOR. “No other retirement vehicle does such a good job at shielding retirement savings via tax deferment, especially in combination with a 401(k) plan. After 2008, many people, Boomers especially, were left with a much smaller nest egg that they expected. Cash balance plans allow them to quickly ramp up on saving.”

What Is a Cash Balance Plan?

A cash balance plan is a variation of a defined benefit retirement plan. Employers make a contribution to the plan on the employees' behalf. Since cash balance plans have some characteristics of a defined contribution plan (e.g, creating participant accounts), they are also known as hybrid plans. Employers contribute to these accounts based on an interest crediting rate (ICR) and a percentage of the employee's pay. This, says Sage's research, produces a plan that is easy to understand.

The research advocates a "common sense methodology," whereby cash balance liability matching is the sum of the participants' account balances. The methodology also calls for illustrating investment scenarios for plans with different ICRs such as fixed rates, bond yields and index returns.

Challenges of Cash Balance Plans

There are, however, hurdles that a company still needs to clear before adopting a cash balance plan. When it comes to managing the assets of such a plan, there are challenges.

"It is not like a traditional defined benefits plan or a total return plan," Pekker said. "First is the ICR and designing a targeting mix that achieves the plan's goals. There's also liquidity risk, which ties into lump sum payments, to be considered. Also, you never really know when people will terminate their employment, or retire and take a lump sum payment."

"You also have to consider the risk preferences of the plan sponsor, the size and structure of the company," Elwell added. "It's really not one size fits all."

Investing Cash Balance Assets

There's not a single best investing strategy for cash balance plans, contended Pekker. "It can depend on whether the plan is new or converted. If it was converted from a defined benefit plan, there may be obligations from that plan that need to be fulfilled. The key is flexibility."

Elwell added, "What we have seen is that some companies will go with as much as 100% fixed income investments, while others may invest 20% to 30% outside of fixed income. There are volatility issues to consider, seeing as it's a pretty risk-averse environment out there."

Plan sponsors have several ways of determining their risk tolerance, according to Pekker. "Different market scenarios have to be considered and the company needs to see how they will respond to each one of them."

“The company has to determine if they can handle the environment of an averse market,” adds Elwell. “Is too much pain going to be felt and will the plan require them to make additional contributions? These are questions that have to be asked.”
The research concluded that in a relatively short period of time, cash balance plans have gone from being a novel part of the retirement plan system to being an increasingly common form of retirement plan. Given the current macroeconomic environment, demographics and tax policy, this trend is likely to continue into the next decade.

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Using Pension Funds to Build Infrastructure and Put Americans to Work

America’s infrastructure—its roads, bridges, water and sewer systems, energy grids, and telecommunications systems, to name a few—is outdated and is, in far too many places, crumbling due to lack of sufficient public investment. America’s construction workers faced levels of unemployment close to 14 percent in 2012, and our construction industry is experiencing lackluster levels of activity, as the value added by the industry in 2011 was still more than $100 billion lower than the prerecession high. And while public and private employee pension funds are confronting distressing levels of unfunded liabilities due to the most recent market crash and rising levels of retirement—with 90 percent of the pension funds that responded to a Wilshire Consulting survey reporting higher amounts of liabilities than assets—public pension funds and private funds managing union pensions have more than $4.5 trillion in assets. Any one of these indicators alone would signal deep economic distress. Together, they should be setting off alarm bells that new economic policies are needed. The Center for American Progress is calling for new federal policies that encourage responsible pension-fund investment in U.S. infrastructure projects because such policies can help reverse these negative trends and make a significant contribution to putting the economy on sounder footing.

The Center for American Progress estimates that all levels of government, together with the private sector, invest approximately $130 billion annually in energy, surface transportation, and water infrastructure. But the estimates also show that an additional $129 billion per year is needed for at least the next 10 years to repair and improve our transportation and water systems, dams and levees, and energy infrastructure, all of which are critical to supporting globally competitive businesses and a high quality of life in communities across America.

Private investment from sources such as pension funds cannot close this gap in infrastructure funding unilaterally. Nevertheless, it makes sense to find ways to accelerate private investment in infrastructure so that annual government appropriations can be directed to projects in which user fees or other dedicated revenues such as gas taxes or sales taxes and the expanded use of tolling—fees charged for the use of highway facilities—is not likely to be sufficient to repay investors. CAP estimates that at least $60 billion a year in infrastructure improvements could be financed with private capital, thereby relieving federal and state budgets of this upfront cost, although in some cases government appropriations may be part of the mix of funds used to repay investors over time. Even with a ready and eager pool of private investment capital, public policies that promote an increase in dedicated revenues are needed to generate the funds necessary to repay investors for their risk and effort.

Canada, Australia, and many of the EU nations are investing more in their infrastructure and modernizing it at a more rapid pace than the United States. A significant portion of this updating and expansion is being financed with pension-fund capital invested in projects through public-private partnerships, which give investors an equity stake in the infrastructure asset through a long-term lease—commonly known as a concession agreement—or through outright ownership. In some high-profile infrastructure projects overseas, U.S. pension funds are major investors. The largest public pension fund in the United States, the California Public Employee Retirement System, for instance, recently took a 12.7 percent equity stake in the London Gatwick Airport with a $155 million investment.

Pension funds are making these types of investments when opportunities align well with their investment-portfolio needs and can thus contribute to achieving fund solvency. Over the next decade investment consultants forecast that pension funds will invest $3.5 trillion in traditional infrastructure and what is termed “social infrastructure”—public buildings such as schools, government facilities, and hospitals. According to The Financial News, “the investments … in these funds … would build 170,000 new hospitals or pay for 73,000 miles of three-lane motorway, enough to circle the globe three times.”

This hefty level of investments represents a very small share of overall U.S. and international pension-fund investments. The Organization for Economic Co-operation and Development, or OECD, estimates that less than 1 percent of pension funds worldwide are invested in infrastructure projects, excluding indirect investment in infrastructure via the equity of listed utility companies and infrastructure companies.

U.S. pension funds are much less active in infrastructure investment than their counterparts in Canada, Australia, and the European Union. In Australia, retirement funds, known as superannuation funds, are increasingly investing in infrastructure. While these Australian funds also struggle to find financially feasible domestic infrastructure projects in which to invest, their domestic market is maturing. An average of approximately 5 percent of their assets is invested in Australia, with some funds’ investment stakes in the double digits and representing as much as $80 billion available to invest in infrastructure. The question is: Why are U.S. pension funds less active in infrastructure investment than their international counterparts? What can be done to spur such investment in financially rewarding and publicly needed domestic infrastructure projects? This report highlights the key challenges that U.S. pension funds face in increasing transportation-related investments in roads, bridges, ports, waterways, airports, transit, and rail. It then discusses policy options that are aimed at reducing or removing these barriers.

One key factor in the relatively low level of pension-fund engagement in U.S. infrastructure investment is the existence of the robust tax-exempt municipal-bond market, typically referred to as the “muni market.” In 2012 this nearly $400 billion market offered states and localities easy access to low-cost capital for infrastructure projects. Municipal bonds are financially beneficial to investors with tax liabilities. Since pension funds are not taxable entities, infrastructure projects financed with tax-exempt debt don’t offer pension funds a financially attractive vehicle through which to make investment in U.S. infrastructure projects. That’s the reason pension funds don’t enter the muni market. Likewise, neither state and local governments nor quasi-governmental entities such as ports and airports need to engage pension investors because of the strength of the muni market.

Beyond the muni market’s effect of crowding out tax-exempt investors, where there are infrastructure investments in the United States that offer a competitive rate of return to pension funds, the funds themselves have confronted significant barriers to investments. These barriers include a lack of experience; lack of investment-review capacity; the paucity of opportunities for investments that align with pension-fund needs and expectations; a mismatch between infrastructure deal structure and size and pension-fund needs and obligations; an aversion to operational and headline risks where there is a possibility of negative publicity associated with the investment; and political conflict and uncertainty where the viability of an investment can become subject to legislative action.

One reason to address these barriers is that adding pension funds to the “investor table” increases the number of willing investors, which in turn increases the supply of capital, creating a healthier marketplace that can produce a lower cost for capital. In addition, engaging pension funds at the investor table can mean that there is an investor that will demand employment policies that will ensure that workers are well trained and well paid throughout the construction and operation of the projects. For these reasons, CAP believes that a strategy that increases pension-fund investment in infrastructure will contribute to increasing the pace of American infrastructure repair and improvement while boosting the likelihood that our projects are built by well-trained workers who can do high-quality work.

New federal and state policies and resources can address some of these challenges by helping make pension funds more knowledgeable of and comfortable with infrastructure investments. Options include policies that close the knowledge and capacity gap through education and training, increase investor confidence in the infrastructure sector, and boost the predictability of returns on such investments. Specifically, we suggest:

Closing the information gap to build experience

- Establish a national infrastructure bank that has the capacity to hire experts who can work with pension funds where investment needs align with infrastructure projects.
- Provide seed capital to launch a network of fee-supported nonprofit intermediaries that are not affiliated with any infrastructure funds or other private-investment vehicles to disseminate to pension-fund staff, trustees, and advisors expertise in pension and infrastructure investing.
- Support small working conferences where pension-fund managers and project sponsors work jointly on products, metrics, templates, and any other necessary documents or information that can enable pension funds to review projects according to their needs and give project sponsors a well-informed approach to seeking partnerships with pension funds.
- Establish an industry-standard group that would bring pension funds together to establish benchmarks for infrastructure investment and consider prudent fee structures for public pension funds investing in projects funded in part through tax credits, public grants, or publicly subsidized debt.
- Use the training capacity of the U.S. Department of Transportation to prepare state transportation departments to work in partnership with pension funds, including through the creation of templates for responsible contractor policies and clarification about what categories of projects are likely to be approved for private financing, as well as through clarification of state performance and the earnings expectations of private investors. Tap the expertise of the U.S. Department of Labor to increase the understanding of Employee Retirement Income Security Act-related requirements and the degree to which infrastructure investments meet those requirements for private-pension-fund trustees, managers, and advisors. Where further clarification is required, the Department of Labor should undertake releasing such guidance.

Increasing confidence in the soundness of infrastructure investments

- Fund a pension-trustee training institute that prepares materials for pension-fund fiduciaries and administrators that can build trustee understanding of infrastructure investment and separate the facts and myths about investments made in this sector. Charge the institute with creating tools to help trustees consider risks so that sound decisions can be made about the likelihood of financial or headline risks and the options for addressing these risks should they materialize.

Increasing the financial return to pension funds for investing

- Launch a new federally subsidized, taxable bond instrument that can offer pension funds sufficient return for debt investments in infrastructure. Enable infrastructure projects where pension funds are majority equity owners in order to tap the tax-exempt bond markets for the share of ownership under their control.
- Improve U.S. loan-guarantee and credit-enhancement options to improve protections available for projects in which pension funds are equity owners.

Ensuring that project financing is reliable and predictable

- Enable states to use tolling on all highway lanes where tolling is viable throughout the National Highway System.
- Increase the amount of dedicated and predictable federal revenues available for states to use to offer a reliable and competitive rate of return to investors.

This paper describes the current state of pension-fund activity in infrastructure investments in the transportation-related sectors, explains the barriers to mobilizing more pension-fund investment in the sector, and offers recommendations to address these challenges.

By Donna Cooper and John Craig | March 28, 2013

Many Pensions' Current Approach to De-Risking Actually Increases Risk of Needing to Make Higher Contributions in the Future, According to Cambridge Associates Report; The Common "Glide-Path" Tactic of Reallocating Growth Assets to Fixed-Income Assets as Plans Become Funded Is Too Mechanistic in Today's Low-Interest Rate Environment; Pensions Need to Adopt a Holistic Glide Path That Maximizes Return at Each Targeted Level of Risk

The most popular practice for ERISA pension funds to reduce their funded status risk has been the use of set formulas to automatically move funds from growth assets, like equities, to fixed income assets as the pension plan funded status increases.

Conceptually the "glide-path" approach to de-risking may make sense, as it provides a disciplined framework for reducing risk, and thus decreases the likelihood that plan sponsors will be confronted with unanticipated funding obligations due to adverse market conditions. However, the current environment of extremely low interest rates could, paradoxically, make the current form of this risk-reduction approach more risky, according to "Pension De-Risking in a Low-Rate Environment -- A Better Solution," a new paper from institutional investment advisor Cambridge Associates.

The Problem with the Traditional Glide Path

"In normal markets, shifting funds out of growth assets into liability matching, or fixed income, assets will reduce funding risk but also reduce expected returns and thus increase projected contributions. But in the current environment of fixed income overvaluation and historically low interest rates, the commonly accepted approach to constructing a glide path is likely to result in a significant decline in expected returns. Therefore, the likelihood of a plan sponsor needing to make higher contributions jumps dramatically and presents a formidable financial risk," said David Druley, Managing Director and head of the global pension practice at Cambridge Associates.

Current glide paths are typically "mechanical" in their approach to risk reduction, relying primarily on increasing fixed income assets and reducing growth assets. "The traditional glide path neglects the objective of maximizing return at each targeted level of risk," Mr. Druley said. "The typical approach just uses one lever -- the fixed income allocation -- to reduce risk, and, because of that, may not generate enough return in an environment like the one we are in today."

A "Holistic" Alternative: Use Growth Assets to Regulate Risk

The Cambridge paper calls for an alternative glide path -- a "holistic" one -- that achieves the competing goals of reducing funding level volatility and generating superior returns, while importantly reducing the risk of a significant decline in funding level.

This alternative glide path not only looks at the amount allocated to growth assets, as the traditional glide path does, but it also defines and controls the risk within the growth assets. It does that by utilizing growth assets that emphasize active strategies that rely on manager skill and non-traditional sources of beta (such as distressed credit, hedge funds, and private investments) rather than directional equity market exposure.

"The merits of this approach are accentuated within the current environment of extremely low interest rates," Mr. Druley said. "Carefully moving some growth assets into strategies that derive a significant amount of returns via alpha, or manager value-add, can potentially allow a pension fund to keep more assets in the growth portfolio, operate at the same risk level as the more simple glide paths and generate higher expected returns."

The kinds of strategies included in the growth portfolio are low-beta hedge fund strategies, very active long-only strategies and select private investment opportunities, when appropriate.

"In fact, based on our experience, this holistic approach did a better job of protecting funded status during the 2008 financial crisis. So you get the potential for higher returns and lower realized risk," Mr. Druley added.

The report notes that because the holistic glide path approach usually involves higher exposures to alternative asset classes and strategies, it also entails implementation complexity as well as higher investment management fees.

"Employing this holistic glide path successfully requires significant experience, manager selection skill and an institutional willingness to accept implementation complexity, which requires resources," said Mr. Druley. "Alpha is certainly a zero sum game, but our experience tells us that with the right expertise and guidance an institution can benefit from the potential for higher returns and reduced contributions."

To receive a copy of "Pension De-Risking in a Low-Rate Environment -- A Better Solution," please contact Frank Lentini of Sommerfield Communications, Inc., at lentini@sommerfield.com or +1-212-255-8386.

SOURCE: Cambridge Associates
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United States: DOL Issues Guidance On MAP-21 Annual Funding Notice Requirements

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The U.S. Department of Labor (DOL) recently issued guidance on the new disclosure requirements for single-employer defined benefit plans under the Moving Ahead for Progress in the 21st Century Act (MAP-21). Plan administrators of single-employer defined benefit plans that meet certain requirements must disclose the effect of MAP-21 on the plan's funding and the plan sponsor's minimum required contribution to the plan. The new guidance sets forth technical questions and answers, and includes a model supplement to the model annual funding notice that may be used to comply with the new disclosure requirements. Because calendar year plans must provide the required disclosures by April 30, 2013, plan sponsors should ensure their plans' annual funding notices incorporate the most recent guidance from the DOL.

On March 8, 2013, the U.S. Department of Labor (DOL) issued Field Assistance Bulletin No. 2013-01 (FAB 2013-01), which provides guidance on the new annual funding notice (AFN) requirements for single-employer defined benefit plans under the Moving Ahead for Progress in the 21st Century Act (MAP-21). Plan administrators of single-employer defined benefit plans that meet certain requirements must disclose the effect of MAP-21 on the plan's funding and the plan sponsor's minimum required contribution to the plan. The new guidance sets forth technical questions and answers, and includes a model supplement to the model annual funding notice that may be used to comply with the new disclosure requirements. Because calendar year plans must provide the required disclosures by April 30, 2013, plan sponsors should ensure their plans' annual funding notices incorporate the most recent guidance from the DOL.
Background

Single-employer defined benefit plans are subject to minimum funding requirements under the Employee Retirement Income Security Act (ERISA) and the Internal Revenue Code. These provisions specify the interest rates used to determine the present value of plan liabilities. Prior to the passage of MAP-21, such interest rates were based upon two-year averages of the yields on certain investment grade bonds. As interest rates dropped to historic lows over the past several years, the present value of plans' liabilities increased, such that plan sponsors were required to contribute more money to meet their minimum funding obligations. MAP-21 amended ERISA to provide interest rate stabilization by adjusting the required interest rates as necessary to fall within a specified range, based on a 25-year average.

MAP-21 also amended ERISA to require that plan administrators of certain single-employer defined benefit plans provide notice of the impact of the interest rate stabilization on the plan's funding status. Such information must be included in affected plans' AFNs for plan years that begin in 2012, 2013 and 2014. Plan administrators must distribute AFNs to participants, beneficiaries, labor unions representing such participants and beneficiaries, and, if applicable, the Pension Benefit Guaranty Corporation (PBGC) no later than 120 days after the end of a plan year (April 30 for calendar year plans).

Affected Plans

The new MAP-21 AFN disclosure requirements apply to single-employer defined benefit plans subject to the protection of employee benefit rights and plan termination insurance requirements of Titles I and IV of ERISA for each "applicable plan year" that starts after December 31, 2011, and before January 1, 2015. An "applicable plan year" is a plan year in which:

The plan's funding target calculated using the MAP-21 rates is less than 95 percent of the funding target determined without regard to MAP-21 rates, each of which is to be calculated without regard to the plan's at-risk status. The plan's funding shortfall determined without regard to MAP-21 rates is greater than $500,000 (taking into account at-risk assumptions, if the plan is at-risk) The plan (and any other single-employer defined benefit plans maintained by the plan sponsor and its controlled group members) had 50 or more participants on any day in the preceding plan year

FAB 2013-01 provides additional guidance on how the funding target, funding shortfall, and number of participants should be calculated.

If a plan elected not to use the MAP-21 rates for any purpose for the plan year beginning in 2012, the plan administrator is not required to include the MAP-21 disclosures in the AFN with respect to such plan year. Similarly, if a plan elected to use the full corporate bond yield curve to determine the plan sponsor's minimum required contribution, the plan's AFN for that plan year need not include the MAP-21 disclosures. Special rules apply to PBGC settlement plans and plans of eligible cooperatives and eligible charities.

Content Required

The AFN for an affected plan must include a statement that "MAP-21 modified the method for determining interest rates used to calculate the actuarial value of benefits earned under the plan, providing for a 25-year average of interest rates to be taken into account in addition to a 2-year average." The plan administrator may choose to include the effective interest rates that result from these averages to the extent they are necessary or helpful to understanding the required MAP-21 disclosures and do not have the effect of misleading or misinforming participants. The AFN also must include a statement that the plan sponsor may contribute less money to the plan as a result of MAP-21 when interest rates are at historic lows.

In addition, the AFN of an affected plan generally must provide a table illustrating the funding target attainment percentage, funding shortfall and minimum required contribution, each determined with and without regard to MAP-21 rates, for the applicable plan year and each of the two preceding plan years. However, such values determined "with regard to MAP-21" may not need to be included in the table if, for example, MAP-21 was not effective for a prior plan year or was not used by the affected plan in a plan year.

Model AFN Supplement

FAB 2013-01 provides a model supplement to the model AFN incorporating the content requirements described above. Although not required, use of the model supplement satisfies the AFN content requirements under ERISA. If such a separate supplement is used, it should be attached to the AFN in a prominent manner, such as to the first page of the AFN.

Good Faith Compliance

Pending further guidance, the DOL will treat compliance with FAB 2013-01 as good faith compliance with the AFN disclosure requirements under ERISA. If a plan's AFN was distributed prior to the issuance of FAB 2013-01, the DOL will treat the plan administrator as complying with the AFN disclosure requirements under ERISA if he or she acted in accordance with a good faith, reasonable interpretation of the law.

Conclusion

As the deadline for furnishing an AFN for the 2012 plan year approaches (April 30, 2013, for calendar year plans), plan administrators should carefully review FAB 2013-01 and confirm that the plan's AFN reflects the most recent guidance from the DOL.

The content of this article is intended to provide a general guide to the subject matter. Specialist advice should be sought about your specific circumstances.

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Baby Boomers' Retirement Planning Confidence Trending Downward

The Insured Retirement Institute issued the following news release:

The Insured Retirement Institute (IRI) today released its third annual report on Boomers' retirement expectations that reveals a continuing decline in Boomers' retirement planning confidence. The percentage of Boomers who are confident in their financial preparations for retirement has dropped each year since the report's inception-from 44 percent in 2011 to 37 percent in 2013. Moreover, the majority of Boomers, 61 percent, do not see their financial situation improving in the next five years.

"Boomers continue to face financial struggles in an era when they have the bulk of responsibility for planning and saving for retirement," said Cathy Weatherford, IRI President and CEO. "This has resulted in a generation that lacks confidence in their financial futures as they approach their retirement years. The silver lining to this report is that Boomers who work with a financial professional are much more confident in their retirement plans. They also are more likely to have determined a retirement savings goal, more likely to have retirement savings, and more engaged with their retirement plans. Developing a holistic retirement strategy, saving, and remaining engaged with your plan-these are the fundamental steps toward attaining financial security during one's retirement years."

Key findings from the report:

- 48 percent of Boomers who work with a financial professional are very or extremely confident with their financial preparations for retirement, compared to only 28 percent working on their own.
- 71 percent of Boomers working with an advisor have determined a retirement savings goal and 94 percent have retirement savings. This compares to only 34 percent and 64 percent, respectively, of Boomers who have not consulted an advisor.
- Boomers working with an advisor are more engaged with their retirement plans, as measured by rebalancing of retirement savings accounts. Nearly two-thirds rebalance their portfolios yearly or every few years, while conversely, 61 percent of Boomers who have not consulted an advisor rarely or never rebalance their portfolios.
- 79 percent of working Boomers expect employment during retirement to be a source of retirement income, an increase of 12 percentage points from the 2011 study.
- A noticeable decline in the number of Boomers who are unsure of their anticipated retirement age has appeared-from 35 percent in 2011 to 26 percent in 2013.
- More Boomers will delay retirement until age 70 or later. In 2011, 11 percent of Boomers planned to retire at 70 or later, but by 2013, that percentage increased to 18 percent.

- Overall 21 percent of Boomers reported postponing their retirement.
- While 46 percent of retired Boomers are confident in their retirement preparations and their ability to live comfortably throughout their retirement years, only 32 percent of working Boomers have that same level of confidence.
- Beyond saving for retirement, the majority of Boomers are not confident in meeting other competing financial demands: 69 percent of Boomers lack confidence in paying for their children's college education and 75 percent lack confidence in covering long-term care expenses for their parents.

The study of Americans aged 50 to 66 was released during a conference call with reporters to commence National Retirement Planning Week(TM) 2013. The annual campaign strives to promote and increase awareness for comprehensive retirement planning.

The full report can be found HERE (https://avectra.myirionline.org/eweb/uploads/Boomer%20Expectations%20for%20Retirement%202013%20FINAL.pdf).

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