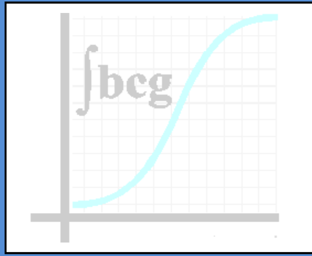


BCG Retirement News Roundup

April 2015, Volume 4, Issue 4

Boomershine Consulting Group, 3300 North Ridge Road, Suite 300, Ellicott City, Maryland 21043

www.boomershineconsulting.com 410-418-5525

Boomershine Consulting Group (BCG) provides 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. If you would like to discuss any of these issues, please contact us.

Inside This Issue

Public Sector/Government Plans

- Excessive Fee Litigation and Public Pension Plans
- The Hard Pension Questions That Are Coming
- Mich. Supreme Court upholds law on teacher pensions
- Moody's further downgrades New Jersey bonds, citing pension shortfalls
- Retirement Assets Total $24.7 Trillion in Fourth Quarter 2014

Private Sector

- Corporate Pension Funds Pile Into Bonds
- Teamsters Mount Grassroots Campaign to Block Pension Cuts
- Heads Up — FASB permits use of practical expedient for retirement benefit plan measurement
- IRS Provides New Flexibility To Correct Retirement Plan Errors
- PBGC premiums are starting to factor into corporate pension decisions

Public Sector/Government Plans

Excessive Fee Litigation and Public Pension Plans

Having just returned from a two-day ERISA litigation conference in Chicago, the topic of fee benchmarking is top of mind. During a rousing session about excessive fee allegations, plaintiffs' counsel Greg Porter (partner with Bailey Glasser LLP) and defense counsel Eric S. Mattson (parter with Sidley Austin LLP) discussed fiduciary litigation, the Exclusive Benefit Rule, the concept of "reasonableness," revenue sharing and much more. What is clear is that this type of dispute between plan participants and sponsors (and their service providers) is likely to show up with increased frequency and extend to other types of employers such as cities and states that provide retirement benefits to their workers. Although municipal plans have not yet squared off in the courtroom against unhappy employees who assert that they are paying too much in fees, recent headlines portend change.

Claims in an April 9, 2015 press release from New York City Comptroller Scott M. Stringer document a concern about the adverse impact of "high fees and failures to hit performance objectives" that "have cost the pension system some $2.5 billion in lost value over the past decade." According to "The Impact of Management Fees on Pension Fund Value," a ten-year "healthy" gross rate of return of 6.5 percent is actually smaller by $2.5 billion when vendor compensation is taken into account. Based on the data considered, private equity has been the largest drag on performance with total value subtracted in the amount of nearly $2 billion.

In Pennsylvania, Governor Tom Wolf is bent on closing a $50 billion pension deficit by taking actions such as lowering costs. A renegotiation of $662 million in fees paid to investment managers by its biggest state retirement systems, the Pennsylvania School Employees' Retirement System and the Pennsylvania State Employees Retirement System, could save money and put the plans on more of an equal footing with the national average of fee levels. See "Gov. Wolf thinks pension funds paying too much in fees" by Len Boselovic (Pittsburgh Post-Gazette, April 12, 2015). Others point to an anemic contribution rate as the culprit. In "The Annual Required Contribution Experience of State Retirement Plans" (March 2015), National Association of State Retirement Administrators ("NASRA") researchers Keith Brainard and Alex Brown categorize New Jersey and Pennsylvania as outliers due to their "notably" low Annual Required Contribution ("ARC").

Although a few years old, a database at Governing.com presents state-specific information about change in dollar assets and management fees. Refer to "Are State Pension Funds Paying Wall Street Too Much?" by Mike Maciag (Governing, August 15, 2012). A report by the Maryland Public Policy Institute examines its experience relative to that of other state retirement plans with a specific focus on whether Wall Street advisors should charge less by eschewing actively managed strategies and adopting a passive approach instead. Click to read

"Wall Street Fees, Investment Returns, Maryland and 49 Other State Pension Funds" by Jeff Hooke and John J. Walters (July 2, 2013).

Disclosure of said fees is another component of the ERISA litigation world and will surely be part of municipal lawsuits as well. In its February 18, 2015 no-action letter, the U.S. Securities and Exchange Commission ("SEC") informed non-ERISA plan sponsors about its reporting obligations in order to avoid compliance mishaps relating to Rule 482 of the Securities Act. Each investment vendor to a reporting entity such as governmental and other non-ERISA sponsors of 457(b) deferred compensation plans, 403(b) plans and church 401(a) plans must agree in writing that it will "provide the DOL required investment information on each investment option it offers under the particular non-ERISA plan, as well as the respective fee and expense information…" on a regular basis. Click to read the SEC letter to the American Retirement Association.

Having worked as an economic expert on fee cases for plaintiffs' counsel as well as defense counsel (depending on the matter at hand) and having carried out various research projects as a fiduciary consultant, my take is that these cases are seldom simple. Fee arrangements can reflect bundled services that must be thoroughly understood as part of the benchmarking exercise. An asset manager's fee may be higher than another fund that generates a similar historical return because that investment company has implemented robust risk management technology or otherwise put in place protective mechanisms that are meant to protect institutional investors (and by extension, their beneficiaries). The key to unlocking fee "truth" is to examine a variety of facts and circumstances and then seek to compare vendor compensation levels against those of real peers.

In anticipation of further "excessive fee" cases that allege bad practices on the part of ERISA and non-ERISA plans, the industry will no doubt spend considerable time on what levels make sense and why.

Copyright © 2015, Fiduciary Leadership, LLC.

The Hard Pension Questions That Are Coming

New reporting requirements are going to make many pensions look worse off -- even if they're not. Public officials need to be ready to talk about that.

If your government provides its workers with traditional defined-benefit pensions, you should know about recent changes in accounting and financial reporting requirements. They're about

to make your life uncomfortable. New pension reporting will likely prompt challenging questions from the media, plan participants and taxpayers.

The changes in the way governments must measure and disclose information about pension plan assets and liabilities are the result of new rules from the Governmental Accounting Standards Board (GASB). The changes will mean that the pension funds of many governments -- those that haven't been doing as well as others in funding their retiree obligations -- will "appear significantly worse off than a year ago," as an article in the January issue of Governing noted.

Before sensational stories about pension underfunding begin appearing in the media, elected and appointed officials and others involved with administering governmental retirement plans need to understand the changes so that they can respond to questions in a better-informed way.

Although many public pension plans will appear to be less well funded, it is important to remember that the new GASB rules don't change the economic reality of the existing pension obligations. They do not require changes in the way plan-funding contributions are determined. The new rules do make it easier for plan participants, unions and taxpayers to monitor pension plan performance and current financial status, and they improve the information available to policy-makers to make key decisions.

Under the new GASB requirements, all state and local governments participating in defined-benefit pension plans will use the same method to calculate and report their net pension liabilities and pension expenses. Use of a standardized calculation method means that, for the first time, policy-makers can make meaningful comparisons of ratios of fund assets to employer liabilities and other key measures across plans, governments and time. Increased comparability makes it easier to evaluate requests for cost-of-living or other benefit increases and to resist pressure to underfund pension obligations.

Pension plans and some state and local governments are now issuing fiscal year-end 2014 financial reports that include these new and different pension disclosures, and it won't be long before the headlines about widespread underfunding of pension plans begin, along with challenging questions from concerned plan participants, advocacy groups and taxpayers. Now, before those questions start rolling in, is the time to communicate three simple facts:

1. Actual pension obligations have not changed because of the new accounting standards; only the way they are measured and reported has changed.

2. Many pension plans will appear to be less well funded. This does not mean plan participants' benefits are less secure than they were when the amounts and ratios were computed differently.

3. The GASB accounting and reporting changes do not require changes in the way plans are funded. Funding decisions are made by policy-makers, not by accountants or accounting standards.

This new era of transparency and prominence for information on public pensions certainly will present challenges for public officials, but proactive communications now should mitigate some concerns and minimize the spread of misinformation. Helpful articles, summaries, fact sheets, videos and implementation guidance that can be used to improve public understanding of the pension accounting and reporting changes are available in GASB's free, downloadable Pension Toolkit.

There's another good reason for officials to make the effort now to learn how to answer difficult questions about pension liabilities: GASB is actively considering requiring governments to recognize and report retiree health-care liabilities following an approach similar to the new pension reporting standards. If that happens, it's likely that those mostly unfunded liabilities are also going to cause the government's financial position to look worse than previously. That will put an even higher premium on clear, concise and timely communications.

Copyright ©www.governing.com

Mich. Supreme Court upholds law on teacher pensions

The Michigan Supreme Court, rejecting arguments from unions, has upheld a 2012 state law requiring teachers to put more of their pay toward their pension plans or face cuts to benefits.
The Michigan Supreme Court, rejecting arguments from unions, has upheld a 2012 state law requiring teachers and other school employees to put more of their pay toward their pension plans or face cuts to benefits such as post-retirement health care.

The 6-0 ruling upheld a January 2014 ruling by the Michigan Court of Appeals and an earlier ruling by an Ingham County Circuit Court judge. Only the court's newest member, Justice Richard Bernstein, did not participate in the decision.

"We hold that the act does not violate any provision of either the Michigan constitution or the United States Constitution," wrote Justice Stephen Markman.

The law, backed by Gov. Rick Snyder and the Republican-controlled Legislature, was intended to cut an estimated $45-billion unfunded liability in the Michigan Public School Employees Retirement System by more than $15 billion.

Under the law, school employees hired before 1990 — who were paying nothing toward retirement — must contribute 4% of their pay or have their benefits cut. Those hired from 1990 to June 2010 must pay 7% to keep their pensions intact. Previously, they paid 3% to 6.4%.

Those hired since the middle of 2010 are in a 401(k)-type pension plan and aren't affected by the law.

In 2012 lawmakers also ended employer-provided health care for new hires, and instead gave them a match of up to 2% in their 401(k), plus a lump sum upon retirement to pay for health insurance. Current retirees must pay at least 20% of their medical premiums.

The American Federation of Teachers and the Michigan Education Association unions argued the law impaired contracts and amounted to uncompensated takings of pension benefits.

But both the Michigan Supreme Court and the appeals court said the law doesn't violate a Michigan constitutional provision protecting earned pension benefits, because only future benefits are affected. Also, unlike an earlier law that mandated 3% contributions toward health care, the 2012 law provides an opt-out provision, the court said.

Markman said the court is "not oblivious to the fact" many teachers consider the changes "unfair and unsatisfactory." But he said "decisions concerning the allocation of public resources will often leave some parties disappointed," and changes should be pursued through the Legislature, not the courts.

The courts earlier struck down a 2010 law which required teachers to put 3% of their pay toward retirement costs but included no opt-out provision.

© 2015 www.freep.com.

Moody's further downgrades New Jersey bonds, citing pension shortfalls

Moody's Investors Service downgraded New Jersey's general obligation bonds by one notch to A2, citing the state's “weak financial position and large structural imbalance, primarily related to continued pension contribution shortfalls.”

The ratings agency, which issued a report Thursday describing its reasoning, also maintained a negative outlook on the state.

"The negative outlook reflects our expectation that the state's financial and pension position will weaken further before pension reform, if successful, is implemented," the report said.

"Without meaningful structural changes to the state's budget, such as pension reform that dramatically improves pension affordability, the state's structural imbalance will continue to grow, and the state's rating will continue to fall," the report added.

The downgrade affects $2.2 billion in general obligation bonds as well as $30 billion in appropriation-backed and other general obligation-related debt, the Moody's report said.

The report didn't provide a detailed discussion of New Jersey's public pension system, but it said one factor that could help New Jersey's rating go up was "improved pension contributions and funding that eliminates the risk of pension asset depletion."

New Jersey is mired in legal and legislative battles over contributions to the state pension system and Gov. Chris Christie's recommendations for changing the system.

On May 6, the New Jersey Supreme Court will hear oral arguments on a challenge by more than a dozen public employee unions against the governor's withholding $1.57 billion in contributions from the state's $77.1 billion pension system for the fiscal year ending June 30.

The New Jersey Pension and Health Benefit Study Commission, appointed by Mr. Christie, announced in February recommendations that included freezing the New Jersey Pension Fund, Trenton, and creating a new cash balance plan for current and future participants.

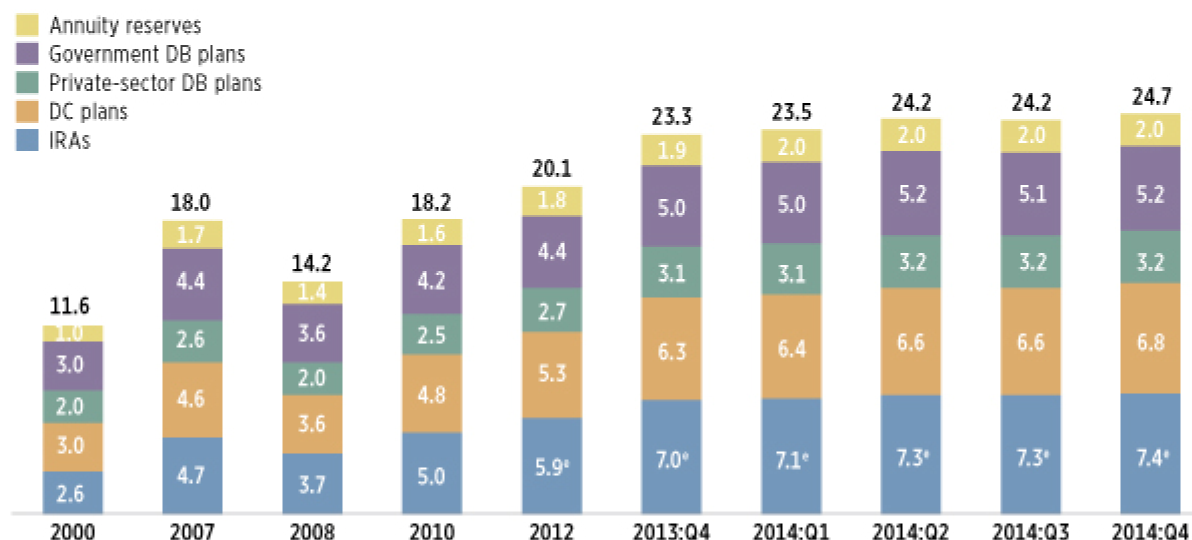
Copyright © 2015 Crain Communications Inc

Retirement Assets Total $24.7 Trillion in Fourth Quarter 2014

Total U.S. retirement assets were $24.7 trillion as of December 31, 2014, up 1.7 percent from $24.2 trillion on September 30, 2014, and up 6.0 percent from year-end 2013. Retirement assets accounted for 36 percent of all household financial assets in the United States at the end of the fourth quarter of 2014.

U.S. Total Retirement Market

Trillions of dollars, end-of-period, selected periods



*Data are estimated.

Note: For definitions of plan categories, see Table 1 in "The U.S. Retirement Market, Fourth Quarter 2014." Components may not add to the total because of rounding.

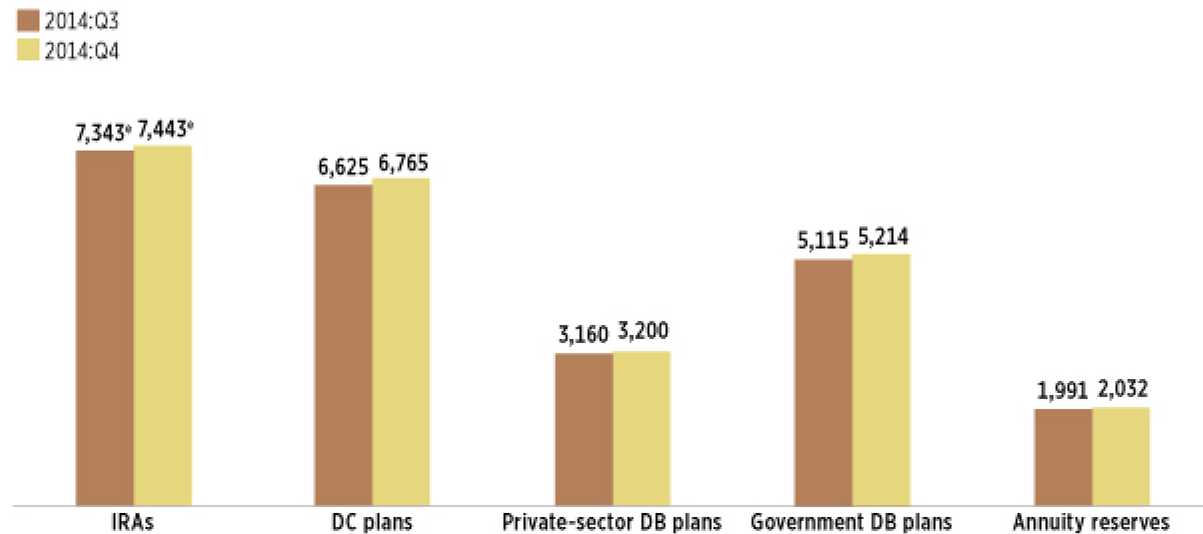
Sources: Investment Company Institute, Federal Reserve Board, Department of Labor, National Association of Government Defined Contribution Administrators, American Council of Life Insurers, and Internal Revenue Service Statistics of Income Division, and Government Accountability Office

Assets in individual retirement accounts (IRAs) totaled $7.4 trillion at the end of the fourth quarter of 2014, an increase of 1.4 percent from the end of the third quarter. Defined contribution (DC) plan assets rose 2.1 percent in the fourth quarter to $6.8 trillion. Government defined benefit (DB) plans — including federal, state, and local government plans — held $5.2 trillion in assets as of the end of December, a 1.9 percent increase from the end of September. Private-sector DB plans held $3.2 trillion

in assets at the end of the fourth quarter of 2014, and annuity reserves outside of retirement accounts accounted for another $2.0 trillion.

Retirement Assets by Type

Billions of dollars, end-of-period, 2014:Q3–2014:Q4



*Data are estimated.

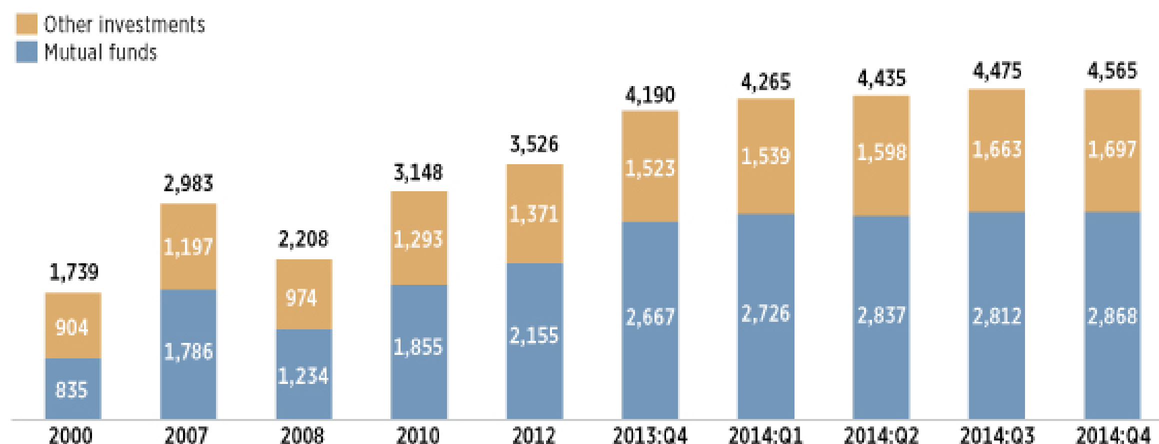
Sources: Investment Company Institute, Federal Reserve Board, Department of Labor, National Association of Government Defined Contribution Administrators, American Council of Life Insurers, and Internal Revenue Service Statistics of Income Division

Defined Contribution Plans

Americans held $6.8 trillion in all employer-based DC retirement plans on December 31, 2014, of which $4.6 trillion was held in 401(k) plans. Those figures were $6.6 trillion and $4.5 trillion, respectively, as of September 30, 2014. In addition to 401(k) plans, at the end of the fourth quarter, $560 billion was held in other private-sector DC plans, $951 billion in 403(b) plans, $261 billion in 457 plans, and $427 billion in the Federal Employees Retirement System's Thrift Savings Plan (TSP). Mutual funds managed $3.7 trillion, or 55 percent, of assets held in DC plans at the end of December.

401(k) Plan Assets

Billions of dollars, end-of-period, selected periods



Note: Components may not add to the total because of rounding.

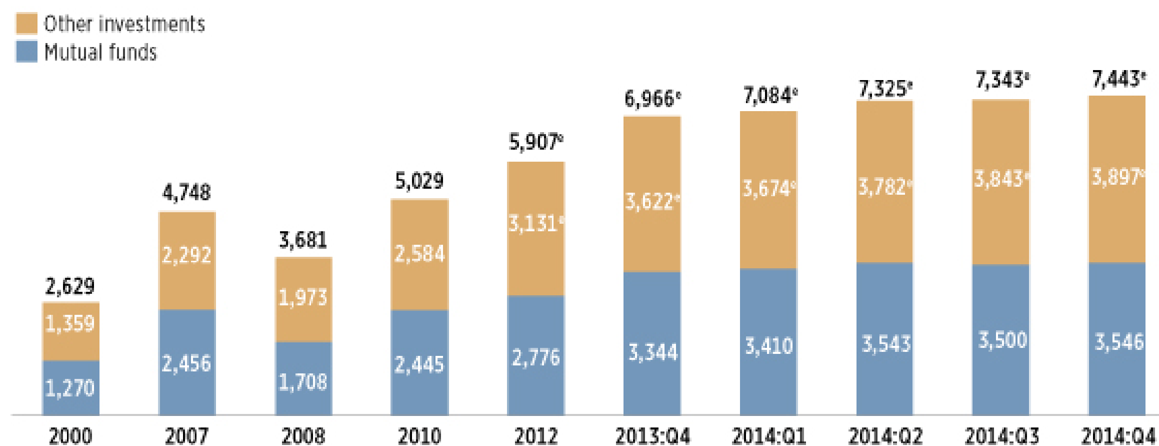
Sources: Investment Company Institute, Federal Reserve Board, and Department of Labor

Individual Retirement Accounts

IRAs held $7.4 trillion in assets at the end of the fourth quarter of 2014, up from $7.3 trillion at the end of the third quarter of 2014. Forty-eight percent of IRA assets, or $3.5 trillion, was invested in mutual funds.

IRA Market Assets

Billions of dollars, end-of-period, selected periods



*Data are estimated.

Note: Components may not add to total because of rounding.

Sources: Investment Company Institute, Federal Reserve Board, American Council of Life Insurers, and Internal Revenue Service Statistics of Income Division

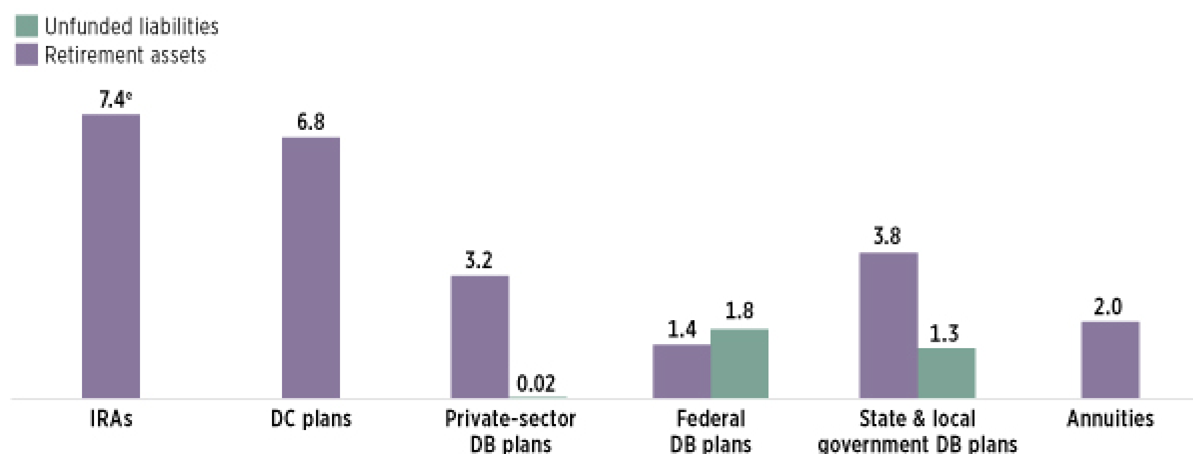
Other Developments

Retirement entitlements include both retirement assets and the unfunded liabilities of DB plans. Under a DB plan, employees accrue benefits to which they are legally entitled and which represent assets to U.S. households and liabilities to plans. To the extent that pension plan assets are insufficient to cover accrued benefit entitlements, a DB pension plan has a claim on the plan sponsor.

As of December 31, 2014, U.S. total retirement entitlements were $27.8 trillion, including $24.7 trillion of retirement assets and another $3.1 trillion of unfunded liabilities. Including both retirement assets and unfunded liabilities, retirement entitlements accounted for 41 percent of the financial assets of all U.S. households at the end of December.

Unfunded liabilities are a larger issue for government DB plans than for private-sector DB plans. As of the end of the fourth quarter of 2014, unfunded liabilities were 1 percent of private-sector DB plan entitlements, 25 percent of state and local government DB plan entitlements, and 56 percent of federal DB plan entitlements.

U.S. Total Retirement Entitlements
Trillions of dollars, end-of-period, 2014:Q4



*Data are estimated.

Copyright © 2015 by the Investment Company Institute

Private Sector

Corporate Pension Funds Pile Into Bonds

Corporate pension plans have become a force to be reckoned with in the bond markets.

For the first time in more than a decade, large pension funds hold more bonds than stocks. Their increased appetite is fueling demand for highly rated debt issues, pushing up prices and driving down yields. That, in turn, could make it cheaper for companies to borrow money for years to come.

The trend is being driven by finance executives who have grown increasingly conscious of the risk underfunded pension plans pose to earnings. Last year ballooning pension obligations hurt the fourth-quarter profits of several large companies, including AT&T Inc., General Motors Co. , and Kellogg Co.

"It's just crippling to companies," said John Jeffrey, a consultant at benefits adviser Conrad Siegel Actuaries. "They don't know what's coming."

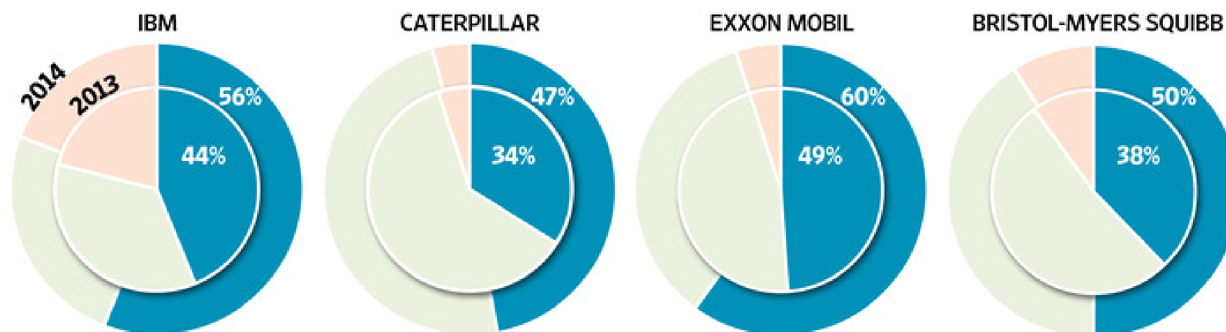
Companies with defined-benefit pension plans—those that guarantee a set payout—have been struggling to fund their obligations to retirees since 2008, when the recession sent asset values tumbling and liabilities soaring.

By increasing their holdings of long-term bonds, companies can more closely match their returns to their future commitments. Such asset-and-liability matching allows companies to limit the volatility of their pension obligations and lock in gains.

The strategy also can reduce the hit a company's earnings might take if the value of its pension plan's stockholdings fall, and can make a pension plan more attractive to outsiders, reducing the premium a company might have to pay to shift its pension burden to a third party.

GM, Verizon Communications Inc., and Bristol-Myers Squibb Co. , among others, have transferred more than $40 billion in pension obligations to insurers in the past three years.

The 50 largest defined benefit plans in the S&P 500 held 41% of their $941.7 billion in total assets in bonds last year and 37% in stocks, according to Goldman Sachs Asset Management. That's the first time bonds have outweighed stocks since at least 2002, when the firm started tracking the data.



International Business Machines Corp. , Exxon Mobil Corp. , and GM are among the companies that have been vacuuming up investment-grade corporate debt. But, because pension funds tend to be buy-and-hold investors, their mass move into bonds is making it increasingly hard to find the long-term, high-quality debt issues the plans need.

Last year, Meritor Inc. boosted the fixed-income holdings in its U.S. pension plan to 41% of the plan's total assets from 36% the year before—an $88 million increase.

These days, however, it can take the company's pension-plan managers more than a month to find the kind of bonds they want, and they may have to pay a premium for them. "It's getting a little bit more challenging," said Carl Anderson, the auto- and truck-parts maker's treasurer.

The shift to bonds could accelerate in the coming years as the Federal Reserve debates whether to raise benchmark interest rates, said Rafael Silveira, a portfolio strategist at J.P. Morgan Asset Management. Such a move would increase rates offered on new bonds, making them more attractive to pension plans and other investors.

Yields on high-rated U.S. corporate bonds maturing in 10 years or more have been below 5% since March of last year. During the recession, yields topped 9%, according to Barclays PLC.

To be sure, some pension funds are still looking to invest more in the stock market in the short term to help their funding status. Underfunding generally increased last year as lower interest rates raised the current value of future payments promised to retirees.

A broader set of pension data based on the Russell 3000 Index, which tracks the 3,000 largest U.S. companies, shows that equities still outweigh bonds, according to J.P. Morgan Asset Management, by 50% to 39%.

Still, the moves by the bigger pension plans are significant. “Normally, the larger plans are the leaders in some trends,” said Mr. Silveira.

Stocks have the potential to return more than bonds, so having more stocks could juice asset values. But stocks are also riskier, and many companies would prefer to avoid the risks.

As more funds adopt the matching strategy, pension demand for long-term, investment-grade debt could total about $150 billion a year, said Michael Moran, pension strategist at Goldman Sachs Asset Management. That would be a sizable chunk of the market.

Last year, companies sold a record $604.9 billion of investment-grade bonds with maturities of 10 years or longer, according to Dealogic. That’s almost double the annual average of $318.3 billion since 1995.

Justin D’Ercole, head of U.S. investment-grade syndicate at Barclays, estimated that pension funds account for more than half of the buyers for new 40-year and 50-year corporate bonds. A few years ago, he would have pegged their share at around 25%.

Companies are seizing on that demand to raise capital. Last week, demand for 50-year bonds issued by Massachusetts Mutual Life Insurance Co. was so strong that the company raked in $500 million, much more than its originally planned $350 million. In February, Microsoft Corp. sold $2.25 billion of bonds maturing in 40 years.

The fact that retirees are living longer is something companies must face. New accounting standards on life expectancy issued late last year are forcing more finance executives to increase the size of their pension obligations. That’s compelling many to consider how they want to carry that burden on their balance sheets.

GM began actively matching its pension assets with its obligations about five years ago, after emerging from bankruptcy proceedings, said Dhivya Suryadevara, chief executive and chief investment officer of the auto maker’s asset-management division.

The market crash of 2008 reminded corporate executives of the risks that falling interest rates and stock prices posed to their balance sheets, said Ms. Suryadevara. She said that moving into bonds earlier than most helped GM get ahead of the competition.

GM's U.S. pension plan, which is 86% funded, holds roughly 60% of its assets in bonds, up from about 42% in 2009.

Because of its size, the company has to be careful when buying bonds. "You don't want to tilt the market," she said.

Collectively, however, corporate pensions are doing just that.

Copyright ©2015 Dow Jones & Company, Inc

Teamsters Mount Grassroots Campaign to Block Pension Cuts

Teamsters are up in arms over looming pension cuts that could slash the incomes of both current and future retirees—anyone under 80.

They're battling trustees of the enormous Central States Pension Fund, which has said that cuts of up to 30 percent may be necessary, as soon as possible, to keep from running out of money. Those trustees represent both management and their international union.

At the same time, worker and retiree activists are also battling corporations bent on eliminating pensions altogether. The latest political blow came in December when Congress passed a bill, in the middle of the night, to allow cuts to certain already-earned pensions.

Bob Amsden drove a truck in Wisconsin for 33 years, over the road and local. He said he got involved because he "couldn't believe they would do something like this to the people who built this country.

"We don't contribute to their pockets, so they went after retirees. If they can beat us down, the rest will fall like putty."

A dozen meetings around the Midwest and South over the last month have attracted 100 to 200 angry members apiece, as activists and local retiree clubs learn their benefits are in danger. The meetings are likely to grow in size and number: Central States has just sent out notices to every member warning that cuts are coming.

Committees have formed in Cleveland, Columbus, the Twin Cities, Milwaukee, Cincinnati, St. Louis, Memphis, and North Carolina. Activists are scheduling meetings with their Congresspeople and writing them letters, leafleting and raising questions at local union meetings and Teamster retiree clubs, and pestering the Teamsters International to do something.

An April 8 rally near Chicago, outside a meeting called by Central States officials to inform Teamster local officers, drew 150 members from eight states, including as far away as Georgia.

Amsden says the average Central States pension is $1,230 a month ($14,760 a year). "You take 30 percent of that away and what will they have to live on?" he asks.

Politicians say they don't want to pay for a "bailout" of the fund, but Amsden predicts, "They are going to bail us out one way or another. People who never expected any government assistance in their life, they're going to have to go for food stamps."

For those with decent pensions—some make $36,000 a year—the cuts could be as high as 65 percent, said Mike Walden, a 31-year Roadway driver who founded the northeast Ohio group.

Sue Cole, wife of a retired carhauler and a founder of the Teamsters Local 604 Pension Protection Committee in St. Louis, said, "They act like 30 or 40 percent is no big deal. Our feeling is that we worked for it. They mismanaged it, we didn't. Why should we lose any portion of our pension?"

CAN THEY DO THAT?

Pensioners have counted on the fact that it was illegal to cut benefits for the already retired, thanks to the 1974 ERISA law. But last December Congress passed the Multiemployer Pension Reform Act—after heavy lobbying by Central States, which became the poster child for troubled pension funds.

The act was tacked onto the "Cromnibus" appropriations bill (which kept certain government functions from shutting down) to avoid debate and so that no Congresspeople had to take clear responsibility for it.

It created a new category of multi-employer pension fund: "critical and declining." If a fund is projected to run out of money in 15 to 20 years, its trustees now have the right to cut benefits, after a vote of the beneficiaries.

Anti-cuts activists point out that, because the stock market is doing well, the Fund is actually richer now than it was at the end of 2008, after the financial meltdown. It has $18 billion in assets, versus $17.3 billion then. Such gains aren't likely in the future, but the Fund's current relative health is reason enough, they say, to slow down and take a look at other possible solutions.

Walden spoke scornfully of Thomas Nyhan, who, he points out, made $662,000 in 2013 as executive director of Central States: “In his letter to people April 8 he said he’s sorry he can’t find an easier solution. I agree, there’s nothing easier than just cutting our pensions. Don’t do anything that might require thinking.”

The committees are gathering petitions demanding that the Fund seek a “second opinion,” an independent audit of its actuarial and financial status.

“We know it’s in trouble and will run out if no steps are taken,” says Ken Paff of Teamsters for a Democratic Union, which is backing the retirees’ movement. “But how did they determine that it has 11 years till it runs out? I used their figures and I got 17. Let the members see behind the curtain.”

The Teamsters pension movement has joined the Pension Rights Center, the AARP, and some unions to support a soon-to-be-introduced bill to delay or repeal the cuts and back up troubled plans.

Congresswoman Gwen Moore of Wisconsin wrote to the committee in her state, “I refuse to force beneficiaries to be singled out as the first to sacrifice in the reform... If you are going to take the extraordinary measure to change long-standing ERISA laws on benefit cuts, then all the reforms need to be made at once so that everyone is putting skin in the game simultaneously.”

STACKED VOTE

Under the law, both retirees and active workers get to vote on any cuts—but a failure to vote counts as a “yes,” and in a big fund like Central States, the Secretary of the Treasury can override a “no” vote and impose the cuts anyway.

The law requires arguments on both sides to appear in the ballot mailing, but with five statements in favor of swallowing the cuts and just one against.

Nonetheless, assuming the Fund opts for draconian cuts, activists will campaign hard for a “no” vote. “We call it social disruption,” Amsden said. “We’re doing a media blitz. We have 11 committees throughout the Midwest; they’re all forming Facebook pages.” In March his group made the front page of Milwaukee’s daily paper.

They expect the Fund to tell members the exact amounts of the proposed cuts this summer, and to hold a vote in early fall. “We’re going to ride the pony till it dies,” Cole said. “We are going to say no because we aren’t guaranteed they won’t come back in another year and ask for more.”

VOTING ON THE PERPS

Pensions will certainly be an issue in the 2016 election for top Teamster officers, as President James Hoffa and his officers back the cuts and challengers Tim Sylvester and Fred Zuckerman blame Hoffa for the decline of the Fund.

In the last officers' election only 300,000 of the 1.3 million Teamsters voted, with two challengers receiving a combined 41 percent of the vote. So the 65,000 working Central States Teamsters could prove a formidable voting bloc.

The officers sometimes try to have it both ways. At the April 8 Chicago rally against the cuts, International Vice President John Murphy showed up to praise the demonstrators and claim Hoffa was on their side. Meanwhile, inside the Central States meeting, international representatives were telling local officers the cuts were mandatory.

Walden says his many calls to Teamster headquarters have gone unreturned. "As far as transparency and communication, they're avoiding us," he said.

The single biggest reason Central States is in trouble is that the international union allowed UPS, by far the largest employer of Teamsters, to leave the fund in 2008. The Fund's annual income would be about double if 45,000 UPS workers in those states were still members.

But Hoffa let UPS out, in return for the company's letting him organize 13,000 workers at a new subsidiary, UPS Freight. Those workers now have a union contract—but with an inferior pension.

Copyright Labor Education and Research Project © 2005-2013

Heads Up — FASB permits use of practical expedient for retirement benefit plan measurement

On April 15, 2015, the FASB issued ASU 2015-04,[1] which gives an employer whose fiscal year-end does not coincide with a calendar month-end (e.g., an entity that has a 52- or 53-week fiscal year) the ability, as a practical expedient, to measure defined benefit retirement obligations and related plan assets as of the month-end that is closest to its fiscal year-end. The ASU is effective for public business entities for financial statements issued for fiscal years beginning after December 15, 2015, and interim periods within those fiscal years. For all other entities, the ASU is effective for financial statements issued for fiscal years beginning after December 15, 2016, and interim periods within fiscal years beginning after December 15, 2017. Early application is permitted, and the ASU should be applied prospectively.

If elected, the practical expedient would be an accounting policy that the employer would need to apply consistently to all plans. The employer would also be required to disclose the policy election as well as the resulting alternative measurement date used for its year-end measurement of retirement benefit obligations and plan assets.

Background

Under current U.S. GAAP, an employer that sponsors a defined benefit retirement plan (for pension or other postretirement benefits) is required to measure its retirement benefit obligations and plan assets as of its fiscal year-end (with the exception of plans sponsored by a consolidated subsidiary or equity method investee that has a fiscal year-end that is different from the parent's or investor's).[2]

The FASB established the practical expedient as part of its simplification initiative,[3] recognizing that an employer whose fiscal year-end does not coincide with a calendar month-end may have difficulty and incur additional costs in measuring the fair value of plan assets for its defined benefit retirement plans. Since third parties often provide information about fair value and classes of plan assets only as of the month-end, electing the practical expedient would relieve an employer from having to adjust the asset values to the appropriate fair values as of its fiscal year-end.

Editor's Note: In practice, some employers with fiscal year-ends that do not coincide with a month-end have nevertheless used measurements of the fair value of plan assets as of the nearest month-end as a reasonable approximation of the fiscal-year-end asset values. In such situations, the employer has needed to support its assertion that those amounts were "reasonably expected not to be materially different"[4] from the results of a more precise measurement as of the fiscal-year-end measurement date. The practical expedient removes the requirement for the employer to perform this analysis in support of the reasonableness of its month-end fair value measurement.

Other Provisions of the ASU

The ASU also provides guidance on accounting for (1) contributions to the plan and (2) significant events that require a remeasurement (e.g., a plan amendment, settlement, or curtailment) that occur during the period between a month-end measurement date and the employer's fiscal year-end. An entity should reflect the effects of those contributions or significant events in the measurement of the retirement benefit obligations and related plan assets.

Specifically, the funded status would be adjusted to reflect (1) an addition to plan assets for a contribution made after the measurement date but before the fiscal year-end or (2) a deduction from plan assets for a contribution made after the fiscal year-end but before the measurement date. The employer would not be required to adjust the fair value of each class of plan assets for a contribution made between the measurement date and fiscal year-end. Instead, the contribution amount would be disclosed separately to reconcile to the fair value of all the classes of plan assets reflected in the fiscal-year-end balance sheet. The ASU provides the following example of this disclosure:

		Fair Value Measurements at February 3, 20X5 (in thousands)		
Asset Class	Total	Quoted Prices in Active Markets for Identical Assets (Level 1)	Significant Observable Inputs (Level 2)	Significant Unobservable Inputs (Level 3)
Cash	$ 14,770	$ 14,770	$ —	$ —
Equity securities:				
U.S. companies	41,200	37,000	1,200	3,000
International companies	32,900	24,000	7,600	1,300
Mortgage-backed securities	13,335	—	12,780	555
Assets at fair value at measurement date of 1/31/20X5	102,205	$ 75,770	$ 21,580	$ 4,855
Contributions after measurement date	25,000			
Total assets reported at 2/3/20X5	$ 127,205			

If a significant event requiring remeasurement occurs between a month-end measurement date and the employer's fiscal year-end, the effect of the significant event should be accounted for in the fiscal year in which the event occurs. However, as a separate practical expedient, an entity may elect to measure the effects of a significant event as of the calendar month-end closest to the date of the significant event. This practical expedient for a remeasurement related to a significant event can be elected by an entity on a case-by-case basis as significant events occur at any time of the year and does not need to be consistently applied for all significant events.

Editor's Note: This separate practical expedient related to significant events could also be elected by an entity that has a fiscal-year-end that coincides with a month-end since a significant event requiring remeasurement could occur on any date. In practice, many entities have historically applied similar practical approaches for certain types of events, such as lump-sum settlements that extend over a period in which plan participants make lump-sum elections upon retirement.

The ASU clarifies that in applying either practical expedient, an employer should not adjust the month-end measurement of the benefit obligations and related plan assets for other events outside its control that occur between the month-end measurement date and its fiscal year-end (e.g., changes in interest rates).

Benefit Plan Financial Statements

The practical expedients permitted under ASU 2015-04 do not apply to plan financial statements prepared in accordance with ASC 960, ASC 962 or ASC 965. However, on March 19, the EITF tentatively decided to permit similar practical expedients for such plan financial statements as part of Issue 15-C, "Employee Benefit Plan Simplifications." The Task Force decided that an employee benefit plan could use an alternative measurement date consisting of the month-end date closest to its fiscal year-end. However, it concluded that contributions and distributions made, and other significant events that occur, between the alternative measurement date and the fiscal year-end would be disclosed rather than adjusted for in the plan's financial statements. See Deloitte's March 2015 EITF Snapshot for additional information.

---

[1] FASB Accounting Standards Update No. 2015-04, Practical Expedient for the Measurement Date of an Employer's Defined Benefit Obligation and Plan Assets.

[2] ASC 715-30-35-62 and ASC 715-60-35-121. For titles of FASB Accounting Standards Codification (ASC) references, see Deloitte's "Titles of Topics and Subtopics in the FASB Accounting Standards Codification."

[3] Launched in June 2014, the FASB's simplification initiative is intended to reduce the cost and complexity of current U.S. GAAP while maintaining or enhancing the usefulness of the related financial statement information. The initiative focuses on narrow-scope projects that involve limited changes to guidance.

[4] ASC 715-30-35-1 and ASC 715-60-35-1.

© 2015 Deloitte Global Services Limited

IRS Provides New Flexibility To Correct Retirement Plan Errors

The IRS recently issued important updates to its Employee Plans Compliance Resolution System (EPCRS). The updates are contained in Revenue Procedures 2015-27 and 2015-28.

EPCRS allows sponsors and administrators of tax-qualified retirement plans and certain other plans, such as Section 403(b) plans, to correct certain documentary and operational errors that occur as to such plans and thereby preserve the tax-advantaged status of those plans. This WorkCite highlights the more important modifications made by the revenue procedures and discusses the impact of these modifications on retirement plan sponsors.

Correction of Overpayment Errors

Rev. Proc. 2015-27 clarifies the methods available to correct an overpayment error. Overpayments generally occur when a participant or beneficiary receives a distribution from the plan that exceeds the amount that properly should have been paid to that participant or beneficiary. Previously, correction of an overpayment required the plan sponsor "to take reasonable steps to have the Overpayment returned to the plan." Some plan sponsors have been interpreting that language as requiring that they demand recoupment from the recipient of the full amount of the overpayment. The IRS apparently does not want to encourage strict recoupment actions, particularly in cases where recoupment would cause financial hardship for affected participants and beneficiaries, because overpayment typically results from errors in plan administration for which the participant or beneficiary bore no responsibility.

The new guidelines on overpayment provide greater flexibility by acknowledging that a demand for repayment is not required in all circumstances. As modified by Rev. Proc. 2015-27, EPCRS now provides alternative methods for correcting an overpayment. For example, in lieu of asking for repayment, an employer or another person might make a contribution to the affected plan equal to the amount of the overpayment, plus interest. In addition, correction may in certain cases be accomplished by the plan sponsor adopting a retroactive plan amendment that conforms the plan's language to the manner in which payments were administered. Other correction methods also may be used, provided that they are consistent with the general correction principles for EPCRS.

The IRS has requested comments on whether further modifications should be made to these new guidelines on overpayments. The IRS is interested in whether, and under what circumstances and conditions, correction should require the plan sponsor to make corrective contributions rather than recouping prior overpayments from participants and beneficiaries, and whether there are any unusual circumstances in which full corrective payments to the plan should not be required for overpayments.

Extension of Time to Self-Correct Excess Annual Contributions

Section 415(c) of the Internal Revenue Code (Code) limits the total amount of “annual addition” (principally contributions and forfeiture allocations) that can be allocated annually to a participant’s account in a defined contribution plan ($53,000 in 2015). Any excess annual addition can be self-corrected under EPCRS if the plan has established practices and procedures to prevent recurrence.

Rev. Proc. 2015-27 modifies EPCRS to make it clear that a plan meets this condition for self-correction so long as the excess annual contributions for a year are “regularly corrected” by returning elective deferrals to affected participants within 9½ months (previously 2½ months) after the end of the year to which the contributions relate.

Lower Filing Fee for Plan Loan Errors

Errors in structuring or administering loans to participants from their plan account balances can be burdensome to correct because EPCRS generally requires that correction of the faulty loan be made through a filing with the IRS under the Voluntary Correction Program (VCP) in order for the loan not to be treated as a taxable distribution. Under prior rules, the fee for a VCP filing to correct a loan error generally was based on the number of participants in the plan. Thus, a large plan with only a few faulty loans would be required to pay a large filing fee to fix a relatively small error.

Rev. Proc. 2015-17 modifies the filing fee for plans using VCP to correct loan errors by basing the filing fee solely on the number of affected participants. For example, under prior VCP guidelines, a sponsor of a 1,200-participant plan for which the only failure was a plan loan error that affected 45 participants would have been required to pay a fee of $7,500. Under the new fee schedule, the sponsor of that plan would pay a filing fee of only $600.

Correction of Elective Deferral Errors

The second new revenue procedure, Rev. Proc. 2015-28, modifies EPCRS to provide three new safe-harbor correction methods for errors relating to employee elective deferrals in Section 401(k) and 403(b) plans. These errors (Deferral Errors) include not implementing elective deferrals pursuant to an affirmative election or pursuant to an automatic contribution feature (including an automatic escalation feature) and not affording an employee the opportunity to make an affirmative election because the employee was improperly excluded from the plan.

The new safe-harbor correction methods are intended to respond to concerns that employers are not implementing automatic contribution features because administrative errors often are more common in plans with such features and such errors typically are not discovered until preparation of the Form 5500 annual report. Rev. Proc. 2015-28 also reflects the IRS’s response

to comments that current EPCRS safe-harbor correction methods for the exclusion of eligible employees, and for failing to implement a salary reduction election, create a windfall for affected employees because under current EPCRS rules such employees receive both their full salary and a 50 percent corrective contribution.

Deferral Errors Relating to Automatic Contribution Features

If the Deferral Error is the failure to implement an automatic contribution feature for an affected eligible employee, or the failure to implement an affirmative election of an eligible employee who is otherwise subject to an automatic contribution feature, and the error does not extend beyond the end of the 9½-month period after the end of the plan year of the error (generally, the filing deadline for the Form 5500, including automatic extensions), no qualified nonelective contributions (QNECs) are required to be contributed to the plan to correct the error under EPCRS if the following requirements are satisfied:

- Timing. Correct deferrals begin to be made no later than the earlier of (i) the first payment of compensation made on or after the last day of the 9½-month period; and (ii) if the plan sponsor was notified of the error by the affected eligible employee, the first payment of compensation made on or after the last day of the month after the month of notification.

- Notice. The affected eligible employee is notified no later than 45 days after the date on which correct deferrals begin. The notice must include the following:

- General information related to the error, such as the percentage of eligible compensation that should have been deferred and the approximate date that such compensation should have begun to be deferred; this information need not include a statement of the dollar amounts

- A statement that the appropriate amounts have begun (or will begin shortly) to be deducted and contributed to the plan

- A statement that corrective contributions relating to missed matching contributions (if any) have been made (or will be made); information related to the date and amount of such contributions need not be provided

- An explanation that the affected participant may increase his or her deferral percentage in order to make up for the missed deferral opportunity, subject to applicable Code Section 402(g) limit ($18,000 for 2015)

- The plan name and plan contact information (including name, street address, e-mail address and telephone number)

- Missed Matching Contributions. Corrective contributions for any missed matching contributions, adjusted for earnings, are made by the last day of the second plan year following the year in which the error occurred.

This correction method also provides an alternative safe-harbor method for calculating earnings. If an affected eligible employee has not affirmatively designated an investment alternative, earnings on the missed contributions may be calculated based on the plan's default investment alternative. However, any cumulative losses reflected in the earnings calculation will not result in a reduction in the required corrective contribution relating to any matching contributions.

This correction method is available only for plans with Deferral Errors relating to automatic contribution features that begin before 2021. The IRS will consider whether to extend this correction method for Deferral Errors beginning in later years. In deciding whether to extend this correction method, the IRS will take into account, among other relevant factors, the extent to which there is an increase in the number of plans implemented with automatic contribution features.

Deferral Errors That Do Not Exceed Three Months

If a Deferral Error occurs for a period that does not exceed three months, no QNECs are required to be contributed to the plan to correct the error under EPCRS if the following requirements are satisfied:

- Timing. Correct deferrals begin to be made no later than the earlier of (i) the first payment of compensation made on or after the three-month period that begins when the Deferral Error first occurred; and (ii) if the plan sponsor was notified of the error by the affected eligible employee, the first payment of compensation made on or after the last day of the month after the month of notification.

- Notice. The affected eligible employee is notified no later than 45 days after the date on which correct deferrals begin. The notice is required to contain information similar to that for Deferral Errors under an automatic contribution arrangement.

- Missed Matching Contributions. Corrective contributions for any missed matching contributions, adjusted for earnings, are made by the last day of the second plan year following the year in which the error occurred.

Deferral Errors That Extend Beyond Three Months

If the period of a Deferral Error exceeds three months, but does not extend beyond the last day of the second plan year following the year in which the error occurred (or the conditions for the

other safe-harbor correction methods described above are not met), a plan sponsor may correct the error under EPCRS by making contributions equal to 25 percent of the missed deferral in lieu of the higher QNEC if the following requirements are satisfied:

- Timing. Correct deferrals begin no later than the earlier of (i) the first payment of compensation made on or after the last day of the second plan year following the plan year in which the Deferral Error occurred; and (ii) if the plan sponsor was notified of the error by the affected eligible employee, the first payment of compensation made on or after the last day of the month after the month of notification.

- Notice. The affected eligible employee is notified no later than 45 days after the date on which correct deferrals begin. The notice must include the same information as required for correction of Deferral Error that do not exceed three months.

- Missed Matching Contributions . Corrective contributions (including the 25 percent QNEC and employer contributions to make up for any missed matching contributions), adjusted for earnings, are made by the last day of the second plan year following the year of the Deferral Error.

Other Changes to EPCRS

Rev. Proc. 2015-27 includes a number of other, more limited changes and clarifications to EPCRS. These include expanding eligibility for reduced VCP filing fees if the sole error is to timely pay required minimum distributions; exempting sponsors from having to file determination letter applications in certain cases when correction will be accomplished through adoption of a plan amendment; and extending the period for adopting corrective plan amendments in situations where a determination letter application is required to be filed concurrently with the VCP application. There are also updates to the forms for certain VCP submissions.

Implications and Considerations for Plan Sponsors

The changes to the EPCRS program described above are, on the whole, quite helpful. They not only provide a greater degree of flexibility in structuring corrections, but they also alleviate some of the burdens inherent in certain previously required correction methods. For example, changes to the guidelines for correcting errors in participant loans will in many cases make it much less expensive to correct those errors.

In light of the significant administrative resources that the IRS has invested in the EPCRS program, plan sponsors should be mindful that failure to correct known plan qualification errors using EPCRS comes at the risk of more expensive sanctions if those errors are later identified in an IRS examination of the plan.

© 2015 McGuireWoods LLP

PBGC premiums are starting to factor into corporate pension decisions

With recent legislation greatly increasing premiums payable to the PBGC, they have now reached a level at which they become a material consideration in decisions such as funding, risk transfer and investment policy.

Now too big to ignore

There are a number of considerations that go into corporate (single-employer) pension decisions. Until recently, PBGC premiums were not a major consideration, representing a marginal (albeit unwelcome) charge. But these premiums got bigger as a result of the Moving Ahead for Progress in the 21st Century Act of 2012 (MAP-21) and increased again under the Bipartisan Budget Act of 2013. As a result, they are now hard to ignore when policy decisions are being made.

The PBGC premium has two components: a flat-rate (per headcount) premium and a variable-rate premium based on the funding shortfall of assets below vested benefits. The variable-rate premium is, however, subject to a cap. When that cap applies, it changes the incentives that apply to certain decisions—more on that below. But I'll start with the background.

Up to a threefold increase

The flat-rate premium was $35 per participant as recently as 2012, is currently $57 per person, and will be $64 per person in 2016, rising with wage inflation after that. The variable-rate premium was 0.9% of the vested benefit funding shortfall in 2013, is currently 2.4% of the vested benefit funding shortfall and will be at least 2.9% of the vested benefit funding shortfall in 2016. This percentage will also increase with wage inflation. So that adds up to something between a two-fold and a three-fold increase over the period 2012 to 2016. The variable-rate premium is, however, now capped—currently at $418 per participant, rising to $500 per participant in 2016.

Route 1: pay down the shortfall

Many corporations are currently taking advantage of funding relief that was provided in the Highway and Transportation Funding Act of 2014 (HATFA), and have reduced contributions into their plans. But the penalty on a funding shortfall will soon be running at almost 3% a year. That's effectively dead money.

HATFA's funding relief uses an adjusted discount rate to produce a lower liability, but the shortfall used for the PBGC premium calculation does not use that adjusted discount rate; you could be fully funded for the HATFA calculation, yet still find yourself paying a substantial variable-rate premium to the PBGC. So this is a big enough penalty that in many cases it will change the balance in the funding decision, encouraging sponsors to put in more than the minimum required contribution. Consider this statement by a CFO:

I like the flexibility of having dry powder in the balance sheet. But the math is now overwhelming: PBGC premiums mean it is too expensive for us to sit on cash while there is a significant deficit in the pension plan.

That's a hypothetical quote that Jim Gannon, Justin Owens and I put into a case study in a recent handbook about frozen plans. We haven't yet seen the first real-life CFO quotation along those lines in the pensions press, but don't be surprised when we do.

Route 2: reduce headcount
The variable-rate premium depends on the shortfall, but the flat-rate premium depends on headcount. The main ways to reduce headcount are to transfer the liability either to the participant (via payment of a lump sum) or to an insurance company (via purchase of an annuity.) In a recent report, with the clear (albeit less-than-catchy) title of "Participants need better information when offered lump sums that replace their lifetime benefits," the Government Accountability Office highlighted this premium as one factor that is encouraging sponsors to offer lump sum windows to terminated vested participants.

They note (citing Justin Owens' paper on risk transfer) that these terminated vested participants may represent less than one-sixth of a plan's liabilities, but nearly a third of the plan headcount. So that's a segment of the plan membership where the payment of lump sums can be particularly effective at driving down PBGC premium costs.

Be aware of the premium cap
When the premium cap applies, however, the dynamics of the calculation change, and so does the nature of the incentive for the plan sponsor. Once the cap applies, the PBGC premium is no longer affected by changes in the funding shortfall (unless it's reduced by enough that the premium cap no longer applies.) So the incentive to pay down the shortfall (route 1 above) goes away in this case. But the incentive to reduce headcount (route 2) becomes no longer $64 a year from 2016 but $564 a year.

That's perhaps enough that maybe I should have added "and the impact of #3 will blow your mind!" to the title of this blog. It's certainly enough that for plans who are affected by the cap – or are close to being affected by it—there is a very substantial incentive to reduce headcount. If $64 a year is factoring into some decisions, then $564 a year screams for attention.

To get a quick sense of who falls into that category, the cap kicks in when the vested benefit funding shortfall is around $19,500 per participant. There are certainly plans out there—albeit a minority—for whom that is the case. For those plans, a reduction in the plan participant headcount can be a big cost saver.

So—whether the best action turns out to be route 1 or route 2—PBGC premiums have become too big to ignore.

© Russell Investments 1995-2014. All rights reserved