BCG Retirement News Roundup

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

www.boomershineconsulting.com 410-418-5525

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.

Inside This Issue

Public Sector/Government Plans

How the GASB's New Pension Standards Could Make Things Worse

The underfunding of state and local public pensions in the U.S. is around $4 trillion. That amounts to the largest local fiscal crisis facing our nation. The cost ultimately will dwarf that of TARP, the Fannie Mae/Freddie Mac bailout, the S&L bailout, or any other recent American financial crisis.

The agency responsible for public pension accounting, the Government Accounting Standards Board, or "GASB," allows state and local governments to report far greater fiscal health by comparison and collective underfunding of only about $1 trillion. For more than six years, GASB considered changes to address this discrepancy. Very recently, it approved new standards to "substantially improve the accounting and financial reporting of public employee pensions." Astonishingly, their changes could make things worse. True, GASB reforms could reveal several hundred billion more dollars in underfunding. But that small progress is overshadowed by the key reforms GASB omitted.

Currently, public pension funds make their own assumptions about their future investment returns without GASB interference. If public pensions increase the riskiness of their investments, they assume a higher rate of return. Simultaneously, pension funds use that high rate to "discount" their long-term liabilities, which artificially reduces today's sticker price for the future costs of retiree benefits. This practice has no basis in finance or economics and encourages public pensions to make risky investments and then underestimate the amount they owe. It is the principal reason economists think they are hiding trillions of dollars in liabilities. GASB's new standards do little to change this.

Instead, new rules effect soft changes, like requiring funds to explain their discount rates, though many already do. In 2010 the chief New York State actuary explained theirs while avoiding any meaningful financial evaluations. He might at least have heeded Warren Buffet: "I think it's very hard to come up with a persuasive case that equities will over the next 17 years perform anything like ... they've performed in the past 17. If I had to pick the most probable return ... that investors in aggregate ... would earn ... it would be 6%." Alas, New York State chose 7.5 percent.

More troubling, GASB implies it is implementing a "blended," more responsible discount rate for plans that expect to run out of assets before they can pay all the benefits owed to workers. Some call this a "compromise." But GASB has made sure its compromise will have little practical application.

The trick is in how GASB now allows states and cities to calculate solvency: GASB concocted a new, convoluted calculation, where state and local governments can add whatever future investment returns and employer contributions they decide to expect. Their bait and switch gives all of America's public pensions enough discretion to appear 100-percent solvent for the purposes of their discount rate calculations. Therefore, none of the country's pension plans would ever need the new "compromise" rate. This is just like the mortgage applicant who lists his hoped-for earnings in the stock market under his current assets and his expected raises at work as his current salary. We all know how that story ends.

Except GASB; they are still all for that. Indeed, this is precisely what happens when pension plans can inflate their solvency using both fanciful investment returns and hoped-for future employer contributions: They can assume future events will fix any current shortfalls. Ironically, these reforms were supposed to eliminate this kind of chicanery. Instead, GASB has embedded such tricks deeper inside its convoluted new solvency formula.

As a final travesty, GASB will no longer require public pensions to disclose the annual employer payments required to bring their funds back to solvency. In recent years many states have borrowed money from bondholders (Illinois) or the pension fund itself (New York) to make this annual payment, while others didn't pay it at all (New Jersey). Now states won't even have to disclose when they shortchange their annual tabs.

One can only speculate why GASB chose to preserve wide discretion for states and cities to choose discount rates while requiring less disclosure around funding. Perhaps they think these problems are inevitable, so it's better to duck than take action. This means when our pension time bomb explodes, those in charge of our safety will be in their bunker, local governments can claim that they followed their accounting rules, taxpayers will be stuck with a trillion-dollar bailout, and there will be blood.

Illinois Legislators Fail to Agree on Pension Package

CHICAGO — Illinois lawmakers, who gathered at the Capitol in Springfield for a special session on Friday, failed to reach agreement on a pension package aimed at addressing the state’s ballooning fiscal problems.

Pension costs in Illinois now account for 15 percent of a $33.7 billion budget that Gov. Pat Quinn signed in June, compared with 6 percent a few years ago. All told, the state is on the hook for more than $83 billion in unfunded pension liabilities, the worst of any state in the country.

No one in the state denies the crisis at hand. But the protracted fight over how to fix it has been a struggle for Mr. Quinn, a Democrat who is caught between angry unions that helped elect him in 2010 and Republicans asking for deeper cuts as concern grows that bond rating agencies could downgrade the state if a compromise cannot be reached.

“Today is a disappointing day for Illinois taxpayers,” Mr. Quinn said in a statement on Friday evening. “The only thing standing between our state and pension reform is politics.”

States hit hard by the recession across the country have been tinkering with their pension programs in recent years in an effort to fix long-term financing problems as millions of baby boomers reach retirement. Between 2009 and 2011, 43 states enacted some form of major alterations to their retirement plans for public employees and teachers, according to the National Conference of State Legislatures. Such laws were a rarity before 2005.

Lawmakers in Illinois have over the years voted to skip contributions to the state’s pension funds, choosing to use the money for services and other budget essentials instead. For months, they have been divided over new legislation to shore up their pension shortfalls.

One measure would give state employees a grim choice: keep the current 3 percent compounded cost-of-living adjustment to their retirement checks each year and lose state-sponsored health insurance, or keep health insurance, but with lesser annual increases.

That plan, which failed to come to a vote in the General Assembly after negotiations broke down on Friday, would have eliminated the state’s unfunded liabilities over the next 30 years, according to the governor’s budget office.

Union leaders vehemently opposed the bill and said the governor was making public workers carry the burden of a problem that they did not cause. They have suggested closing corporate tax loopholes to help raise state revenue.

At the Illinois State Fair this week, a crowd of union-led protesters, upset with the governor’s proposal, booed throughout his speech as a plane flying overhead pulled a sign that read “Gov. Quinn — Unfair to Workers.” Some were demonstrating again at the State Capitol on Friday.

“You would think a Democratic governor would be on the side of the working people,” said Henry Bayer, executive director of the American Federation of State, County and Municipal Employees Council 31, a public services workers’ union in Illinois, calling the proposed cuts “a Republican program.”

But Mr. Quinn has not felt much love from state Republicans either. They say the proposed cuts are not comprehensive enough because they do not address pensions for teachers, university employees or judges.

“These pension systems in Illinois are on the brink of near collapse,” said Tom Cross, the House Republican leader, stressing the need to “do it right.”

A scaled-back pension bill was debated on the House floor on Friday that would have only altered elected officials’ pension benefits as a “first step.” But even that failed to come to a vote in the Democrat-dominated legislature after it became clear it could not get enough support.

The governor’s budget office, meanwhile, projects that the state’s pension debt continues to grow by $12.6 million each day the debate continues.

By STEVEN YACCINO
Published: August 17, 2012
By STEVEN YACCINO

Legal Constraints Hurt Public Pensions’ Adaptability

August 6, 2012 (PLANSPONSOR.com) – Legal constraints make it difficult for public pension plans to adjust to changing economic and demographic conditions, a report contends.

An issue brief released by the Center for State and Local Government Excellence points out that most states protect pensions under a contracts-based approach, which prohibits a state from passing any law that impairs existing public or private contracts. There are currently a number of lawsuits against states that have attempted to reform public pensions by changing the benefits retirees will receive or the amount of contributions employees will make into their retirement funds (see “Unions Challenge R.I. Pension Changes with Lawsuits”).

Report authors Alicia H. Munnell and Laura Quinby of the Center for Retirement Research at Boston College say the protection of future accruals of core benefits serves to lock in any benefit expansions, limiting policymakers’ ability to respond to changing economic conditions, but future benefits, much like future payroll, should be allowed to vary based on economic conditions. That is, public officials should be able to change future benefits for current workers.

Such increased flexibility for public employers would accord their employees the same protections as workers in the private sector, the report says. The Employee Retirement Income Security Act (ERISA), which governs private pensions, protects accrued benefits but allows employers to change the terms going forward.

The authors point out that for most states, the challenge is to narrow the definition of the contract -- a burden that would fall on the legislature and the courts. First, enacting legislation that the contract is created when the employee performs the service, would establish an ERISA-type standard. Second, if this legislation is challenged, the courts would then need to be persuaded to adopt a more flexible standard in light of changed conditions.

Some states have taken the first step by passing legislation that reduces core benefits for current workers, but the courts have yet to rule on the legality of these changes.

“A failure to permit such changes, however, would have serious consequences,” the report authors contend. They note that limiting pension reductions to new workers reduces pension costs only slowly over time, exempting current workers from cuts creates a two-tiered compensation system under which workers doing similar jobs would receive different amounts based solely on when they were hired, and allowing public employees to enjoy greater protections than their private-sector counterparts is perceived by many as unfair.

August 26, 2012

U.S. Public Pensions Earn 1.15% For Worst Showing Since 2009

U.S. state and local-government pensions ended the 2012 fiscal year with a median gain of 1.15 percent as the European debt crisis and a slowing global economy damped stock returns, Wilshire Associates said.

It was a reversal after two years of gains for the retirement funds, which have $2.8 trillion in assets, according to the U.S. Census Bureau. The performance, included in a report Wilshire is set to release today, may add to political pressure on public workers to accept benefit cuts and increase contributions to the plans.

In the last three weeks, the California Public Employees’ Retirement System, the biggest U.S. pension, reported returns of 1 percent for the fiscal year ended June 30. New York City’s $122 billion pension funds reported preliminary returns of 1.7 percent, and Maryland’s $37.1 billion plan earned 0.36 percent.

“The grave concern with Maryland is it assumes a very rosy and very optimistic return rate of 7.75 percent,” said Christopher Summers, president of the Maryland Public Policy Institute, which promotes policies based on free enterprise and limited government. “You have the 11th or 12th year in a row where the actual liabilities of the pension system are larger than its assets.”

Budget Strain

State and local government pensions count on returns of 7 percent to 8.5 percent to pay retirement benefits for teachers, police officers and other civil employees. To make up for losses suffered during the 2008 financial crisis and the recession, municipal officials had to contribute more to the funds, straining budgets and leaving less money available for services.

Estimates of public-pension funding deficits vary from $757 billion to $4.6 trillion, depending on assumptions. To help close the gap, 29 states made changes to their pensions in the calendar year 2011, such as increasing employee contributions, raising the retirement age and revising automatic cost-of-living adjustments, according to the National Conference of State Legislatures.

Rhode Island enacted the most sweeping change, closing the defined-benefit pension that covers state employees, teachers and many municipal employees. Current members will be transferred to a hybrid plan that consists of a reduced defined-benefit plan and a 401(k)-type account.

Longer View

The median annualized return for public pensions in the past 10 years was 6.32 percent, Wilshire said. Public funds returned 21.4 percent in fiscal 2011 and 12.6 percent in 2010, according to Santa Monica, California-based Wilshire. The median public pension lost 17.4 percent in 2009.

Looking at a one-year snapshot doesn't make sense given the volatility of financial markets and because public pensions operate over a long period, said Jordan Marks, the executive director of the National Public Pension Coalition, a labor- backed group that supports public pensions.

Also, states such as Illinois and New Jersey have short- changed their pensions by not making their annual required contributions, Marks said.

Over 25 years, the median annualized return for public pensions is 8.3 percent, according to the National Association of State Retirement Administrators.
"You have to look at this in terms of a long-term investment strategy," Marks said.

Stock Drag

Bigger allocations to U.S. and international stocks dragged down performance compared with corporate pension funds, which invest more in bonds, said Robert Waid, a managing director at Wilshire.

Corporate pension plans had a median return for the year ending June 30 of 3.68 percent, the best among institutional funds, according to Wilshire. Foundations and endowments had the worst returns, at 0.37 percent.

"In general, allocation to bonds helped all plans," Waid said. "It was a classic story of equity versus bond exposure."

The MSCI EAFE Index (MXEA), which measures stock performance in developed markets outside the U.S. and Canada, lost 13.8 percent for the year ending June 30. The Standard & Poor's 500 Index (SPX) gained 5.4 percent for the period.

The report, compiled by the company's Wilshire Trust Universe Comparison Service, covers about 900 institutional investment trusts, including foundations and endowments, union retirement funds, corporate plans and public pensions.

The median public pension had 54.9 percent of its holdings in stocks, 26.3 percent in bonds, 3.98 percent in real estate and 3.12 percent in alternative investments such as leveraged- buyout or distressed-bond funds. About 2.73 percent was held in cash.

By Martin Z. Braun - Aug 6, 2012 1:49 PM ET

Actuaries Debunk Myth that 80% Pension Funded Ratio Alone Constitutes 'Actuarially Sound;' Recommend Comprehensive Criteria to Judge Pension Fund Health

WASHINGTON (July 31, 2012)—The American Academy of Actuaries cautioned today that a commonly used measure for considering a pension plan healthy—its funded ratio—fails to provide a sufficient measure on its own of a plan's financial health.

"Any realistic assessment of a pension plan should include several measures, not just one," said Senior Pension Fellow Don Fuerst. "Somehow 80% has become a perceived standard but that is a myth we need to replace with facts."

In a new Issue Brief, The 80% Pension Funding Standard Myth, the Academy offers fuller criteria for judging the actuarial soundness of a pension plan. Understanding a pension plan's funding progress should not be reduced to a single measure or benchmark at any single point in time.

Multiple funding ratios should be examined over several years to determine trends, and other factors should be considered when assessing fiscal soundness including:

- The size of the pension obligation compared to the financial resources of the sponsor;
- The financial health of the plan sponsor;
- The funding or contribution policy of the plan; and
- The investment strategy and risk level of the plan assets.

The 80% myth can lead to a dangerous slippery slope," Fuerst added. "It could evolve into an inadequate target if not challenged. Pension plans should have a strategy in place to attain or maintain a funded status of 100 percent or greater over a reasonable period of time."

Date: July 31, 2012
Actuaries Debunk Myth that 80% Pension Funded Ratio Alone Constitutes 'Actuarially Sound;' *Recommend Comprehensive Criteria to Judge Pension Fund Health*

State and Local Government Defined Benefit Pension Plans – a letter from the American Academy of Actuaries to Senator Hatch

July 31, 2012

The Honorable Orrin Hatch
SH-104 Hart Senate Office Building
Washington, DC 20510-4402

Subject: State and Local Government Defined Benefit Pension Plans

Dear Senator Hatch:

In the Senate Finance Committee Ranking Member Report issued earlier this year, "*State and Local Government Defined Benefit Pension Plans: The Pension Debt Crisis that Threatens America*," you address the threat these plans pose to the financial stability of state and local governments and to the retirement security of millions of their workers and retirees. This issue is serious and controversial, and we commend you for addressing it and for your commitment to solve the problem.

Virtually all retirement systems have faced difficult challenges during the recent financial crisis and recession. Critics of defined benefit plans sometimes point to such challenges and suggest the solution is to eliminate them. In a time of challenging economic and financial trends, this may seem to some like a reasonable solution, but it comes at a significant cost to participants and taxpayers and is almost certainly an overreaction.

Pension plans are capable of operating effectively through severe crises. With proper governance and by pooling and managing risk, these plans can provide participants with a secure and steady income through extreme economic conditions. Taxpayers can be well-served by these plans, which deliver this economic security at a reasonable cost when effectively managed.

The Pension Practice Council of the American Academy of Actuaries[1] appreciates meaningful proposals that develop long-term solutions to pension financing problems and that recognize the unique characteristics of these plans. To help you craft such a proposal, we offer these comments with respect to certain aspects of your report.

Essential Goals
In general, we support the four essential goals you identify for public pension reform: affordability and transparency, generational equity, retirement income security, and state and local funding. But, these goals can create internal conflicts. Programs should be affordable, for example, but assuring retirement security is not inexpensive.

Likewise, assuring future taxpayers have no liability for past years can conflict with goals of affordability or retirement security.

Pension plans should fund all obligations in a transparent, reasonable and rational fashion, seeking to minimize cost and, ideally, to allocate that cost to taxpayers who benefit from the services of the workers. But, guaranteeing future taxpayers that they will have no liability can increase current contributions and might result in future generations paying less than their share of retirement costs. Maintaining some flexibility regarding this goal tends to reduce aggregate contributions to the plans.

Suitability of Defined Benefit Plans for State and Local Governments

State and local governments, as well as society as a whole, have an interest in ensuring that retirees have an adequate lifetime income. This interest is particularly acute in localities in which the employees of the state or local government are not covered by Social Security. Without a defined benefit plan, individuals have few effective tools to deal with the challenge of securing lifetime income for themselves. The efficiency of providing lifetime income through a defined benefit plan can be significant.

Defined benefit pension plans create value by pooling risk, particularly longevity risk, among a large number of participants. In addition to the advantages of pooling longevity risk, defined benefit plans pool investments and manage these investments professionally. The net investment returns of professionally managed defined benefit plans typically exceed those of individually managed investments by significant margins[2].

Some pension plans may have taken on more risk than they can sustain or have other governance issues, but this does not imply that all defined benefit plans are unsuitable for state and local governments. These plans can be effectively maintained by state and local governments. Improving the funding and governance of many public plans will not be easy, but the benefits of doing so are substantial for both plan participants and taxpayers.

80 Percent Funded Ratio

The Ranking Member’s report states that “…80 percent is generally considered the indicator of a sound government pension plan.” While there is no single, accepted definition of a sound pension plan, funded status, by itself, is an inadequate measure of the financial strength of any pension plan. An assessment of the financial health of a pension plan needs to take into account the availability of resources to support the plan compared with the expected cost of the plan and the risk of variation in that expected cost.

A funded ratio is a single measure of a plan’s status at one point in time. No single funded ratio should be used as a measure of a pension plan’s financial health. Funded ratios should be scrutinized over several years to examine trends and should be viewed in light of the economic situation at each point in time. Higher funded ratios are expected following periods of strong economic growth and investment returns such as that experienced at the end of the 1990s. Lower funded ratios are expected after recessions such as the one begun in 2008 or after years of poor investment returns. Whether or not a particular shortfall affects the financial health of the plan depends on many other factors.

Other measures of financial health should be examined in addition to funded ratios. These may include:

- Size of the pension obligation relative to the financial size (as measured by revenue, assets, or payroll) of the plan sponsor.
- Financial health (as measured by level of debt, cash flow, profit or budget surplus) of the plan sponsor.
- Funding or contribution policy and whether contributions actually are made according to the plan's policy.
- Investment strategy, including the level of investment volatility risk and the possible effect on contribution levels.

Again, each of these measures should be examined over several years and in light of the economic environment.

Well-governed plans should have a funding policy in place to meet the full costs of these plans as well as a history of adhering to this funding policy. Lack of a funding policy or a demonstrated failure to adhere to a funding policy raises serious concern.

Using 80 percent as an "indicator of a sound government pension plan," as stated in the report, also introduces the potential that some will consider 80 percent funding a goal or target, rather than targeting 100 percent or greater. Such a reduced goal likely would impose an additional cost on future taxpayers and could subject a plan to severe stress in economically troubled times.

The American Academy of Actuaries' Pension Practice Council has just published an issue brief addressing this issue, The 80% Pension Funding Standard Myth.

Exhausted Assets

The Ranking Member's report also states that "…the pension plans of 11 states are projected to have exhausted all of their assets by 2020," and cites a 2009 paper as the source of this projection. The 2009 source paper uses questionable assumptions and simplistic methods to make this assertion. For example, the paper assumes that each plan sponsor would contribute only enough to fund newly accrued benefits, and that none of these funds would be available to pay current benefits. Ten years later the plans are projected to "run out of money" only because the intervening 10 years' worth of contributions plus income (well over $1 trillion in aggregate) are simply assumed to be unavailable to pay benefits. As the GAO noted, “The projected exhaustion dates are thus not realistic estimates of when the funds might actually run out of money.[3]

To illustrate the problem with these projections, consider the state of Oklahoma, which in the report was projected to exhaust its assets in 2017. The June 30, 2011 actuarial valuations for the two largest plans in Oklahoma report assets of approximately $17 billion and benefit payments during the prior year of approximately $1.5 billion. Contributions for the prior year were approximately $1.2 billion. If benefit payments continue to exceed contributions by $300 million, these plans have sufficient assets to last more than 50 years without any investment earnings. Even if benefit payments increase and contributions do not, these plans are not likely to exhaust their assets soon and certainly not by 2020.

The source paper referenced should not be used as the basis for assessing the potential threat that state and local government-sponsored pension plans might pose to their sponsors.

Summary

The Academy’s Pension Practice Council supports your goal of having state and local government pension plans that are affordable, that provide transparent costs, appropriate allocation of costs to all taxpayers (current and future), retirement income security for employees, and full and complete funding by the sponsoring entities. The Academy’s professional staff stands ready to help craft policies to support these goals.

We would be happy to discuss any of these items with you at your convenience. Please contact Donald Fuerst, the Academy’s Senior Pension Fellow (202-785-7871, fuerst@actuary.org) if you have any questions or would like to discuss these items further.

Sincerely,

John H. Moore, MAAA, FSA, FCA, EA
Vice-President, Pensions

William R. Hallmark, MAAA, ASA, FCA, EA
Chair, Public Plans Subcommittee

[1] The American Academy of Actuaries is a 17,000-member professional association whose mission is to serve the public and the U.S. actuarial profession. The Academy assists public policymakers on all levels by providing leadership, objective expertise, and actuarial advice on risk and financial security issues. The Academy also sets qualification, practice, and professionalism standards for actuaries in the United States.

[2] See “Investment Returns: Defined Benefit vs. 401(k) Plans” Center for Retirement Research at Boston College, September 2006 and “DB Versus DC Plan Investment Returns: The 2008-2009 Update” Towers Watson March 2011

[3] “State and Local Government Pension Plans: Economic Downturn Spurs Efforts to Address Costs and Sustainability,” United States Government Accountability Office, March 2012, page 12.

GASB Statements 67 and 68, New Accounting Standards for State and Local Government Pension Plans, Available for Download

Two new standards are now available for download from the Governmental Accounting Standards Board (GASB). In June, GASB announced it had voted to approve the two new standards that will substantially improve the accounting and financial reporting of public employee pensions by state and local governments. Statement No. 67, Financial Reporting for Pension Plans, revises existing guidance for the financial reports of most pension plans. Statement No. 68, Accounting and Financial Reporting for Pensions, revises and establishes new financial reporting requirements for most governments that provide their employees with pension benefits.

Statement 68 replaces the requirements of Statement No. 27, Accounting for Pensions by State and Local Governmental Employers and Statement No. 50, Pension Disclosures, as they relate to governments that provide pensions through pension plans administered as trusts or similar arrangements that meet certain criteria. Statement 68 requires governments providing defined benefit pensions to recognize their long-term obligation for pension benefits as a liability for the first time, and to more comprehensively and comparably measure the annual costs of pension benefits. The Statement also enhances accountability and transparency through revised and new note disclosures and required supplementary information (RSI).

Statement 67 replaces the requirements of Statement No. 25, Financial Reporting for Defined Benefit Pension Plans and Note Disclosures for Defined Contribution Plans and Statement 50 as they relate to pension plans that are administered through trusts or similar arrangements meeting certain criteria. The Statement builds upon the existing framework for financial reports of defined benefit pension plans, which includes a statement of fiduciary net position (the amount held in a trust for paying retirement benefits) and a statement of changes in fiduciary net position. Statement 67 enhances note disclosures and RSI for both defined benefit and defined contribution pension plans. Statement 67 also requires the presentation of new information about annual money-weighted rates of return in the notes to the financial statements and in 10-year RSI schedules.

The provisions in Statement 67 are effective for financial statements for periods beginning after June 15, 2013. The provisions in Statement 68 are effective for fiscal years beginning after June 15, 2014. Earlier application is encouraged for both Statements.

Private Sector

IRS Notice 2012-55 Gives 25-Year Average Segment Rates and Adjusted 24-Month Average Segment Rates Used for Pension Funding

The Internal Revenue Service (IRS) released Notice 2012-55, providing guidance on the 25-year average segment rates that are applied to adjust the otherwise applicable 24-month average segment rates used to compute the funding target under Internal Revenue Code Section 430 and ERISA Section 303. The guidance reflects the changes made to the Code and ERISA by the Moving Ahead for Progress in the 21st Century Act (MAP-21).

Notice 2012-55 will appear in Internal Revenue Bulletin 2012-36 dated Sept. 4, 2012.

Social Security surplus dwarfed by future deficit

WASHINGTON -- As millions of baby boomers flood Social Security with applications for benefits, the program's $2.7 trillion surplus is starting to look small.

For nearly three decades Social Security produced big surpluses, collecting more in taxes from workers than it paid in benefits to retirees, disabled workers, spouses and children. The surpluses also helped mask the size of the budget deficit being generated by the rest of the federal government.

Those days are over.

Since 2010, Social Security has been paying out more in benefits than it collects in taxes, adding to the urgency for Congress to address the program's long-term finances.

"To me, urgent doesn't begin to describe it," said Chuck Blahous, one of the public trustees who oversee Social Security. "I would say we're somewhere between critical and too late to deal with it."

Possible reduction: The Social Security trustees project the surplus will be gone in 2033. Unless Congress acts, Social Security would only collect enough tax revenue each year to pay about 75 percent of benefits, triggering an automatic reduction.

Lawmakers from both political parties say they want to avoid such a dramatic benefit cut for people who have retired and might not have the means to make up the lost income. Still, that scenario is more than two decades away, which is why many in Congress are willing to put off changes.

But once the surplus is spent, the annual funding gaps start off big and grow fast, which could make them hard to rein in if Congress procrastinates.

The projected shortfall in 2033 is $623 billion, according to the trustees' latest report. It reaches $1 trillion in 2045 and nearly $7 trillion in 2086, the end of a 75-year period used by Social Security's number crunchers because it covers the retirement years of just about everyone working today.

Add up 75 years' worth of shortfalls and you get an astonishing figure: $134 trillion. Adjusted for inflation, that's $30.5 trillion in 2012 dollars, or eight times the size of this year's entire federal budget.

What's needed: In present value terms, the Social Security Administration says the shortfall is $8.6 trillion. That means the agency would need to invest $8.6 trillion today, and have it pay returns of 2.9 percent above inflation for the next 75 years, to produce enough money to cover the shortfall.

That's the rate of return Social Security expects to get from its trust funds. The problem, of course, is that Social Security doesn't have an extra $8.6 trillion to invest.

Social Security Commissioner Michael J. Astrue said he is frustrated that little has been done to solve a problem that is only going to get harder to fix as 2033 approaches. If changes are done soon, they can be spread out over time, perhaps sparing current retirees while giving workers time to increase their savings.

"It won't be easy but it's just going to get harder the longer they wait," Astrue said.
There is no consensus in Washington on how pressing the problem is.

President Barack Obama created a deficit-reduction commission in 2010 but didn't embrace its plan for Social Security: raising the retirement age, reducing benefits for medium- and high-income workers and raising the cap on the amount of wages subject to the payroll tax, all very gradually.

The issue has been largely absent from this year's presidential election. Neither Obama nor his Republican opponent, Mitt Romney, has made it a significant part of the campaign.

Blahous, a Republican, warns that the magnitude of the problem is becoming so great that "Social Security's days as a self-financing program are numbered" if Congress doesn't act in the next few years. Democrat Robert Reischauer, Social Security's other public trustee, is less dire in his predictions but has told Congress that it needs to act within five years.

Others express less urgency.

"I would like to see Congress move on this tomorrow but we do have 22 years before there is any cut in Social Security benefits," said Sen. Bernie Sanders, a liberal independent from Vermont who heads the Senate Social Security caucus. "Compared to other crises -- the collapse of the middle class, real wages falling for American workers, 50 million people having no health insurance -- how would I rate the Social Security situation? Nowhere near as serious as these and many other problems."

AARP, the nation's most powerful lobbying group for older Americans, agrees.
"I'm not suggesting we need to wait 20 years but we do have time to make changes to Social Security so that we can pay the benefits we promised," said David Certner, AARP's legislative policy director. "Let's face it. Relative to a lot of other things right now, Social Security is in pretty good shape."

Social Security is financed by a 12.4 percent tax on wages. Workers pay half and their employers pay the other half. Self-employed workers pay the full amount.
The tax is applied to the first $110,100 of a worker's wages, a cap that rises each year with inflation. For 2011 and 2012, the tax rate for employees was reduced to 4.2 percent but is scheduled to return to 6.2 percent in January.

Social Security's finances are being hit by a wave of demographics as aging baby boomers reach retirement, leaving relatively fewer workers behind to pay into the system. In 1960, there were 4.9 workers paying Social Security taxes for each person getting benefits. Today, there are about 2.8 workers for each beneficiary, a ratio that will drop to 1.9 workers by 2035, according to projections by the Congressional Budget Office.

About 56 million people collect Social Security benefits, and that is projected to grow to 91 million in 2035. Monthly benefits average $1,235 for retired workers and $1,111 for disabled workers.

Marge Youngs, a 77-year-old widow from Toledo, Ohio, said Social Security makes up most of her income. She's reasonably sure that Social Security's financial problems won't affect her benefits but worries about her children and grandchildren.

"We might not have to worry about it, but it's the next generation coming up that will," Youngs said.

Corryn Grace Freeman, 22, a recent college graduate from Columbia, Md., said she understands the federal government must address its growing budget problems but worries that her generation will be "penalized" for being born late.

"It's like we're paying for the current elderly, we have to save more for ourselves, and we don't get any help in the future," Freeman said. "And not to mention we're facing one of the toughest job markets that the U.S. has been faced with."

The York Dispatch (Pennsylvania)
August 13, 2012 Monday

More Choice Not Necessarily Best within Retirement Plans

Employers may think that offering lots of retirement fund options is helpful, but new research shows that ordinary investors are overwhelmed by too much choice. In response, they go with simplified diversification strategies and end up with portfolios that aren't as diversified as they appear.

A team of researchers at Rutgers, the University of Pittsburgh, the University of Texas, and Boston College tested how fund assortment size affects investor behavior. They found that when given lots of choices, people tend to spread their money evenly across the funds they choose. They conclude that people act this way because they are mentally drained by the process of choosing funds and this allocation approach seems like an easy way to meet the conventional wisdom of a diversified portfolio.

The analysis appears in the August issue of the American Marketing Association's Journal of Marketing Research . The researchers conducted experiments to show that increasing fund assortment size increases the number of funds that people invest in, and also increases their tendency to spread the dollars evenly among their chosen funds. As a result, people aren't as diversified as they think, increasing their exposure to market swings.

"The research shows that people get overwhelmed by choice. It is one thing to be faced with a big assortment of mustards at the grocery store, where the stakes are low. The order of magnitude is greater with mutual funds, where you feel less informed," says J. Jeffrey Inman, Albert Wesley Frey Professor of Marketing and associate dean for research and faculty at the University of Pittsburgh. He is a co-author of " Investing for Retirement: The Moderating Effect of Fund Assortment Size of the 1/N Heuristic ," along with Maureen Morrin, professor of marketing, at the Rutgers University School of Business; Susan M. Broniarczyk, Sam Barshop Centennial Professor in Marketing Administration at the University of Texas-Austin McCombs School of Business; and Gergana Nenkov, associate professor of marketing, and Jonathan Reuter, assistant professor of finance, both of the Boston College Carroll School of Management.

The findings have implications for human resources officers, fiduciaries of defined benefit plans, and financial services plans. Researchers say that marketers of financial products should do a better job of easing the decision process for investors, especially for those with limited investment knowledge or training. Making the task of investing for retirement simpler and less intimidating may increase employee participation and savings rates, helping to ensure a safer and happier future for retirees.

SOURCE American Marketing Association

August 15, 2012

Future of benefits a critical issue in presidential election Government's role in retirement, health care at turning point

Organizations representing those interests are keenly watching where the candidates stand on the issues. With the candidates' starkly contrasting views, the 2012 campaign season promises to be anything but dull.

Recently, 11 organizations representing employee benefits professionals submitted questions to President Barack Obama and Republican challenger Mitt Romney in an effort coordinated since 1984 by Sam Gilbert, president of The Pension Forum and of United Plan Administrators. The Westlake Village, Calif., firm consults on small-business retirement plans.

In addition to *Pensions & Investments* and the Pension Forum, the organizations were the American Society of Pension Professionals & Actuaries; American Academy of Actuaries; Employers Council on Flexible Compensation; U.S. Chamber of Commerce; Society of Professional Benefit Administrators; National Institute of Pension Administrators; Plan Sponsor Council of America; and Small Business Council of America.

The question of tax reform, and specifically the tax preference for retirement savings, was among the top concerns of the organizations.

Both candidates are under the gun to fix the economy and to get a massive federal budget deficit under control. As a result, long-standing tax incentives for retirement savings are in the cross hairs of revenue hunters, and the groups want to remind the candidates — repeatedly — that the tax deferrals for retirement savings should be off the table because they are not outright deductions.

“It would be really shortsighted and ill-considered to view that as a short-term way to raise revenue,” said Judy Miller, director of retirement policy for the Arlington, Va.-based ASPPA, “My question is: Do they understand that?”

The groups also want to know what the next president will do to encourage employers to keep offering retirement plans.

"The bottom line is that it is much more than a tax treatment," said Edward Ferrigno, PSCA vice president of Washington affairs. "You've got both sides talking about capping contributions, but they have to understand what the impact will be on plan sponsorship and the societal impact if it reduces sponsorship." The PSCA's question is: "The evidence is overwhelming that the single most important factor in amassing retirement assets is whether or not an employer offers a retirement plan to employees. What will you do to encourage (that)?"

The U.S. Chamber of Commerce in Washington, suggested a good way to encourage plan sponsors is to ensure that the Obama administration's emphasis on government efficiency is also encouraged among employers, who want electronic delivery of benefit plan disclosures, and fewer regulatory hurdles.

Social Security

After the federal budget crisis, the groups focused on concerns over the solvency of Social Security.

"We know there will be considerable changes to Social Security," the NIPA notes in its question, which is why the next president will need to create more retirement savings incentives. Possible changes to Social Security include adding individual accounts and raising the retirement age. The American Academy of Actuaries, seeking to gauge the seriousness of their efforts on the issue, asks the candidates: "What is your level of concern?"

The groups' other focus is on what do with all that money in retirement assets, which have jumped to $18.9 trillion today from $2 trillion in 1992, according to an Investment Company Institute estimate. In 1992, the groups asked then-President George H.W. Bush about possible incentives to use those assets to invest in economic development or infrastructure. Mr. Bush acknowledged it presented "a tempting pool of money" that could be used for "socially motivated investments" as long as those investments could stand on their own merits.

Mr. Gilbert agreed that now is the time to think about what more could be done, within the rules of Employee Retirement Income Security Act.

"Pension funds are the biggest lump of money in the world. How are we investing that money to create a better society?"

Ratings Agency Finds Dire Environment for Pensions

August 23, 2012 (PLANSPONSOR.com) - An analysis of pension plans in Canada and the U.S. shows ever increasing funding deficits.

DBRS' "2012 Pension Study: Discounting into the Danger Zone" found only 46.6% of the 451 plans it reviewed are at least 80% funded, the amount considered to be in relatively good shape. The funding deficit for the plans reviewed was $389 billion.

Plan assets dropped significantly during the 2008 economic crisis and have staged only a modest recovery since then, according to the report. This recovery was due to large contributions by employers and positive asset performance post-crisis. As a result of the decline in interest rates, discount rates dropped by approximately 143 basis points over the past four years and pension obligations hit an all-time high in 2011, contributing to the current pension deficit.

Annual employer contributions are at all-time highs due to regulator reforms which require ongoing funding. Employer contributions make up 4% of total obligations annually. DBRS expects this level of funding to continue for at least the next three years.

Since 2000, demographic factors have affected pension plan funding. As Baby Boomers approach retirement age, a smaller number of employees are supporting a greater number of retirees. The increase in benefits paid may put additional pressure on pension plans. Furthermore, longer life expectancies will adversely affect the funded status of pensions.

Based on its analysis, DBRS revised its previously optimistic outlook of pension funding and does not expect full funding to be achievable until 2014 at best. Moreover, DBRS expects defined benefit plans will be slowly unwound and removed over the next 40 years.

Rebecca Moore
editors@plansponsor.com