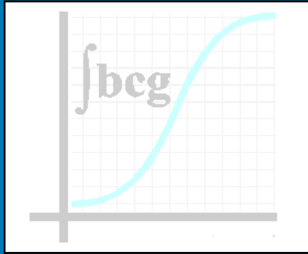

BCG Retirement News Roundup

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

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

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

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Public Sector/Government Plans

Detroit Becomes Biggest U.S. City Ever Eligible for Bankruptcy

Public pensions were dealt a historic blow Tuesday when a Detroit bankruptcy judge sided with the city in ruling that entitlements could be subject to cuts in municipalities under Chapter 9 protection.

A Detroit bankruptcy judge dealt public pensions a historic blow Tuesday when he sided with the city in ruling that the entitlements could be subject to cuts in municipalities under Chapter 9 protection.

The decision came as part of U.S. Bankruptcy Judge Steven Rhodes' 140-page opinion that concluded Detroit is eligible for bankruptcy protection. The decision on pensions is a precedent-setting one as Rhodes is the first bankruptcy judge to rule on retirees' status as creditors.

Rhodes, who spent one and a half hours delivering his opinion from the bench, concluded that the city's pension debt was similar to other creditor debt and that any state constitutional protections for pensions did not apply in federal bankruptcy court. Unions have argued that pensions, which are protected under Michigan's constitution, cannot be impaired. Detroit's claim is that state constitutional protections no longer hold in federal bankruptcy court and that pension payments can be cut like any other debt to creditors.

"Nothing distinguishes pension debts from other municipal debts, notwithstanding the state constitution," Rhodes said, according to media reports. He added that "it has long been understood that bankruptcy law entails the impairment of contracts … [and] pension rights are contract rights under the Michigan constitution."

However he warned that his decision does not mean he will approve a plan with deep pension cuts. "This court will not lightly or casually exercise power … to impair pensions," he said.

Still, the decision sent waves through city governments on Tuesday as many have been closely watching the Detroit case as a potential precedent setter for pension protections in bankruptcy.

"It's huge," said Frank Shafroth, director of the George Mason University Center for State and Local Government Leadership, of the decision. He added that, given the potential implications for this decision on other municipalities, this was not a decision Rhodes came to easily. "I really think at the end of the day, that the judge could not

perceive a way that Detroit could actually have a plan of recovery and get back on its feet unless there were some haircuts to these pensions."

Some, though, are concerned about the ruling's ripple effects given Detroit's unique status. Many factors have worked against the city for years: declining population and revenue, decreased state revenue sharing, escalating personnel costs, mounting debt and high-risk financial gambles that didn't pay off. Not every distressed city has those particular strikes against it.

"I do have some concerns about bad facts leading to a bad precedent," said Michael Nadol, a managing director of PFM Group, in an interview prior to the ruling. He added that "the truly extraordinary nature of Detroit's case" may warrant some unusual measures, "But I'm not sure it's the right case to be setting precedent for other distressed municipalities."

Previous bankrupt municipalities have avoided the issue by not proposing cuts to retirees in their restructuring plan or, in the case of Central Falls, R.I., negotiating an agreement with retirees prior to submitting a restructuring plan. San Bernardino, Calif., which filed for bankruptcy last year, is arguing that the mammoth state pension system CalPERS should take a haircut right alongside the city's bondholders and other shareholders. (California's pensions are protected as contracts under that state's constitution.) The two sides are currently in mediation on the issue.

Shafroth and others have said that the debate over pension status in bankruptcy is an issue that will make its way to the U.S. Supreme Court. If the Detroit ruling stands, it could change the nature of negotiations between unions and cities.

"The unions have said, 'Pensions are constitutionally protected, we don't have to be at the table,'" Shafroth said. "The decision today says, 'Oh yes you do.'"

But unions say Detroit employees have already been to the negotiating table (the city negotiated paycuts and benefits cuts last year) and there is no more room to cut. They point out that the city's pensions, which are less than $20,000 per year for the average retiree, don't afford much wiggle room either. Donald Smith, a 69-year-old city retiree, said his "heart skipped a beat" when he heard the ruling Tuesday. He has a monthly pension of $889 after nearly 30 years with the city and a $1,000 monthly Social Security check. After healthcare deductibles and rent, he lives on about $300 per week.

"I have no idea how I'm going to manage," he said.

The unions have already filed their appeal to Tuesday's ruling and Rhodes is considering a motion to allow that appeal to bypass the district court and go directly to the U.S. 6th Circuit Court of Appeals.

"We are hopeful that our arguments will prevail on appeal regarding the state constitution protecting the rights of retirees," said Michael Artz, associate general counsel at the American Federation of State, County and Municipal Employees. "We think we have strong arguments for our side."

Detroit filed for bankruptcy on July 18, claiming $18 billion in debt, a figure, particularly an estimated $3.5 billion in pension liabilities, unions challenged during the city's eligibility hearing. Rhodes said Tuesday determining the level of underfunding was not important in determining the city's eligibility, but routinely cited that figure and others used by the city when summing up his opinion that Detroit was financially insolvent.

Detroit’s plan of adjustment is due on Mar. 1; city attorneys said they hope to file it before that date.

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by Liz Farmer | December 3, 2013

Detroit pension funds can go straight to U.S. appeals court

Pension funds opposing Detroit's reorganization were allowed by the judge overseeing the case to go directly to the U.S. Court of Appeals in Cincinnati in their effort to pull the city out of bankruptcy.

U.S. Bankruptcy Judge Steven Rhodes in Detroit, in permitting the pension funds to bypass a review by a U.S. district judge, also said he will decide “in the next day or so,” whether the appeal should be heard more quickly than normal.

Mr. Rhodes asked lawyers how going to the appeals court would affect confidential settlement talks being mediated by the chief federal judge in Detroit.

“This is a dual process,” said Lisa Hill Fenning, who represents the city's two pension systems. “We are not trying to slow down the process.”

The systems after the hearing praised Mr. Rhodes' decision to allow the direct appeal and said the challenge should be heard as fast as possible.

“In light of the expedited scheduling of this entire bankruptcy case, it is only appropriate that the appeal process be similarly expedited,” the systems said in a statement.

The pension systems cited a ruling in the bankruptcy of San Bernardino, Calif., to bolster their argument for bypassing the normal process. In that case, a judge in Los Angeles allowed the $277.3 billion California Public Employees' Retirement System, Sacramento, to go to the appeals court in San Francisco.

CalPERS and the Detroit pension systems have similar complaints, claiming city officials didn't negotiate in good faith with creditors before filing for bankruptcy.

The pension funds unsuccessfully tried to strip San Bernardino and Detroit of court protection by attacking rulings that the cities qualify for bankruptcy.

U.S. Bankruptcy Judge Meredith M. Jury refused to let CalPERS avoid the normal appeals process. A federal district court overturned that decision, saying the appeals court should look at the claims about good-faith bargaining.

Detroit won the right to stay in bankruptcy from Mr. Rhodes on Dec. 3. The city filed bankruptcy in July.

San Bernardino filed for bankruptcy last year.

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How One Mayor Pulled His City Back From the Brink of Bankruptcy

PROVIDENCE, R.I.—Angel Taveras had been in office barely eight weeks when his chief of staff walked in with the news. Michael D'Amico had just come from a somber meeting with the city's municipal finance review panel. D'Amico sat in the ancient couch in the mayor's second-floor City Hall office. The window behind him looked out on Providence's "Superman building," a city icon strikingly like the Daily Planet tower of comic-book fame, which was on its way to total vacancy.

Hardly anyone in town foresaw the number that D'Amico brought with him: Providence was facing a $110 million structural deficit, a shortfall sizable enough to bankrupt the city in 2012.

"The number itself was surprising," D'Amico recalls, "but the percentage that that represented was even more shocking." Providence was looking at a $600 million annual budget that would now demand concessions from everyone—the firefighters, police, teachers, city union employees, taxpayers, retirees, and major community institutions.
Taveras, a lanky former housing-court judge with rimless glasses, had been elected mayor expecting a deficit maybe half this size. But Providence's ad-libbed measures during the recession—spending down reserves to keep services going and taxes low—were now about to catch up to the city shortly into his term. Well before Detroit would

set off a rash of municipal bankruptcy fears two years later, Taveras and Providence would confront a confluence of a potential bankruptcy's worst signs: unfunded pension obligations, a disappearing industrial base, a burst housing bubble, and steep cuts in state aid.

"You go into survival mode," Taveras says. "This is about making sure that the city is able to survive."

On the eve of 2014, Providence no longer looks to be in imminent danger. And Taveras is running on the story of the city's turnaround in his bid to become Rhode Island's first Hispanic governor. His narrative is compelling: Taveras grew up in Providence the son of Dominican immigrants. He likes to say that he went from Head Start to Harvard before coming back home. By inheriting the city at one of its lowest points, he can also now claim the mantle of the mayor who refused to let Rhode Island's capital city fail even as questions remain about its long-term fiscal challenges.

The mayor's office was also a springboard for Taveras's predecessor, David Cicilline, who is now a U.S. congressman representing Rhode Island. He was widely criticized for obscuring the city's true finances when they came out on Taveras's time. Cicilline's congressional office did not respond to requests for comment.

Part of Taveras' success in taming the city's deficit came from his demeanor, union and nonprofit leaders say. He does not yell. He did not stake out public demands of the unions. His staff shared bad news with them privately first. Union leaders were also invited to bring their own accountants to the city's books.

"There had been hundreds and hundreds of articles and opportunities where previous administrations had gone after us, demonized us, gone after certain benefits," says Paul Doughty, the president of the local firefighters union, who fought for years with Cicilline. "These guys had the chance to do that at a level never seen before, and they didn't even touch it."

The city instead gave each union a target for the savings it needed, and then asked them to design their own paths to achieve it. When Taveras publicly announced the scale of the deficit in early March 2011, he also cut his own paycheck by 10 percent. That yielded the uninspiring annual savings of $12,500. But the gesture later allowed him to say that of all the sacrifices the city demanded, the largest salary cut was his own.

The deals slowly rolled out over the next two years. The public-employees union agreed to 1 percent pay cuts and waived raises. The firefighters came next, offering larger health care co-shares, and later pensions for new employees. The school day got longer for teachers. Sick days were reduced. Dozens of public employees agreed to retire. One by one, the city's seven largest tax-exempt nonprofits agreed to make

voluntary payments into the city's coffers. Taveras also enticed the City Council to raise property taxes by about 6 percent for the average homeowner.

The last settlement came in April of this year, when a Superior Court judge approved the city's pension agreement with retirees. The deal reduced the city's pension liability by an estimated $170 million, and, crucially, it permits Providence to shift its retirees older than 65 off of private insurance and onto Medicare.

"Without hesitation, if we lost that lawsuit, we would have filed Chapter 9," Taveras says. "There was just no way to avoid it…. I didn't have anything more that I could do." That April settlement marks the last time anyone around City Hall recalls discussing the possibility of bankruptcy, and it was a watershed for the city.

"He deserves a lot of credit for the turnaround, because he has a leadership style that worked very well," says Darrell West, a longtime Providence political observer and former resident, who is now the director of Governance Studies at the Brookings Institution. "He was able to bring together contending parties on pension reform and produce a deal that saved the city money without alienating valuable workers. That's something that's very difficult to do—and the state was not able to do that."

Unions are still challenging the state of Rhode Island's broader pension overhaul in court.

This fall, the ratings agency Standard & Poor's upgraded its outlook on Providence's debt from negative to stable. Just last month, Taveras announced a tentative budget surplus of about $1 million dollars, money that will start to restore the city's rainy day fund.

Yet, there's a case to be made that Providence isn't ready to let go of Taveras. A municipal deficit may be solved in three years, but the same can't be true for the underlying dynamics that led to it. "You can't fulfill a broad vision for economic development, for changing the course of a city, in one or two terms," says Hilary Silver, director of the urban-studies program at Brown University.

John Simmons, the executive director of the Rhode Island Public Expenditure Council, cautions that questions still linger about what will happen in Providence in 2014, in 2015, in 2016, should the broader economy start to unravel again. It will be tempting for another mayor to draw on whatever money Providence tucks away now.

The city's prospects are also closely tied to Rhode Island's trajectory. If the state continues to struggle, then the city will too—with aid drying up and problems passed down to local government.

Taveras sounded upbeat, though, the week after news ran in the Providence Journal that the city had acquired a surplus again. He also delivered a keynote speech at Brown

University to a small conference on the role of Latino politics in this changing state. His message sounded like a dry run of his pitch to the state: a pitch in which he emphasizes his Rhode Island upbringing as well as his fiscal chops.

"I want people to look back on my tenure as mayor and see that it was a time of great challenges, great difficulties, but that we brought people together, we faced them head on," he said. "And were able to really solve a lot of our problems."

Still, it won't be possible to judge the core of his argument for several more years—well after voters decide on their next governor.

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Cities and the Fiscal Challenge of Retiree Health Care

A few big cities are adequately funding health care for their current and future retirees. The rest face distasteful choices.

As state and local governments focus on how to fix their pension problems, a recent report demonstrates the dramatic measures large American cities will have to take to address another issue: huge retiree health-care liabilities. The overarching lesson of the study from ElderBranch, an online information portal that helps people find and evaluate long-term-care providers, is to address the retiree health-care issue before it gets out of hand.

Springfield, Mo., is one city that is trying the tax-hike approach. In 2009, Springfield's voters approved a 0.75 percent sales tax increase. While that tax increase was to address the city's unfunded pension liability, not retiree health care, the way things played out politically is instructive: The tax increase passed only after a proposed 1 percent hike had been voted down. Of the 25 largest American cities, only Boston, Charlotte, Denver and Jacksonville could close their retiree health-care funding gaps with tax increases of 0.75 percent or less. Austin, Detroit and Nashville would need to raise taxes by more than 15 percent.

Spending cuts are no silver bullet either. The same three cities that would have to raise taxes by more than 15 percent to solve their retiree health-care problems would have to cut spending by over 16 percent to achieve that goal.

That leaves the third unpleasant option: reducing health benefits. One approach is to shift more of the health-care cost burden onto employees. But solving the problem that way would require seven of the 25 cities to increase the amount deducted from workers'

paychecks by more than 15 percent. Detroit would have to deduct one-third more than it already does from employee salaries to close its retiree health-care funding gap.

Of course, cities could simply offer less-generous benefits. In 2011, Atlantic City switched to a plan that caps payments to medical providers for retirees. But that's not very appealing for talented individuals who are attracted to the reliable benefits that have traditionally accompanied public employment.

Two other options are somewhat more promising. One is to increase the service time required for retirees to earn health benefits. In 2008, San Francisco voters approved a ballot measure raising the service time needed to qualify for lifetime subsidized health care from a paltry five years to 20 years. Changing the law, whether by elected lawmakers or by the voters at the ballot box, is the right way to approach this issue: The service time needed to earn health benefits should not be subject to collective bargaining.

Perhaps the most promising approach would be to discontinue the practice of allowing new and recent hires to collect retiree health benefits before they qualify for Medicare at age 65. (Exceptions should be made for police officers, firefighters and other public-safety positions for which earlier retirement is the norm.) There is plenty of precedent in the private sector for this approach. Of the private firms that offer health-insurance benefits to their employees, just 28 percent also offer retiree health benefits. Taxpayers shouldn't be expected to fund packages that are far more generous than what private employers provide.

The few cities that have consistently funded their retiree health-care liabilities are in a position to thoughtfully consider various cost-cutting options. But most big cities, for which the problem has become enormous, will have to settle for trying to put out the fire any way they can.

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by Charles Chieppo | December 4, 2013

San Jose pension reforms ruled violation of rights

A superior court ruling announced last week overturned key parts of a voter-approved San Jose pension reform: an attempt to cut employer costs for pensions earned by current workers in the future.

As the city struggled with large deficits during the last decade, the court was told, annual retirement costs more than tripled to $245 million while basic services were cut and the number of police and firefighters dropped.

Mayor Chuck Reed and other Measure B backers argued that cutting the cost of pensions earned by current workers in the future, while protecting amounts already earned, is needed to get significant savings.

But a series of state court rulings are widely believed to mean that the pension offered current workers on the date of hire becomes a vested right, protected by contract law, that can only be cut if offset by a new benefit of comparable value.

Santa Clara County Superior Court Judge Patricia Lucas said in her ruling the question before her court is “one of law, not of policy,” referring to a state Supreme Court response to city and county briefs on an Orange County attempt to cut retirement costs.

“The legal question is whether and to what extent Measure B violates vested rights,” Lucas said of the union lawsuits challenging the measure approved by 70 percent of San Jose voters in June last year.

San Jose attorneys argued that two provisions in the city charter, which allow the city to “amend” or “repeal” retirement plans at any time, prevent the creation of vested rights for employees in the two city-run pension systems.

The city cited language in an appellate court ruling in support of its position. The judge cited contrary language in a state Supreme Court ruling and a footnote in the appellate court ruling saying it should be limited to the peculiar facts of that case.

“Accordingly, this court concludes that a reservation of rights (to amend or repeal the pension plans) does not of itself preclude the creation of vested rights,” Judge Lucas ruled.

The key part of Measure B gave current workers an option: 1) Increased pension contributions of up to 16 percent of pay, but no more than half the cost of paying for the “unfunded liability” debt. 2) A much lower pension for future service.

Lucas rejected city arguments that workers have no vested right to city payment of all of the unfunded liability and that, at times, unions have regarded pension contributions as compensation, which the city can regulate.

A lower pension, avoiding a contribution increase, was similarly rejected with a mention that the plan lacks IRS approval. Orange County has been waiting since 2009 for IRS approval of a lower pension-higher contribution option negotiated with unions.

And a cut of San Jose retiree pension cost-of-living adjustments for up to five years, if the city council declares a fiscal emergency, was overturned by Lucas as a violation of vested rights.

After a five-day trial in July and some follow-up action, the judge ruled on a consolidation of six suits filed by public employee unions and retirees challenging 10 of the 15 sections of Measure B, with 11 different causes of action.

Among the parts of the measure upheld by Lucas is the authorization of pay cuts to get equivalent city savings if the lower pension-higher contribution option is ruled invalid.

The city and unions have agreed to delay pay cuts until at least next July 1. Major savings from pay cuts reportedly could be difficult and are likely to face a legal challenge from police, one of the biggest city costs.

“The City Council earlier this month approved 10 percent pay raises for cops, after police officers began fleeing the department for better-paying cities,” the San Jose Mercury-News said last week. “The cop exodus has coincided with a huge increase in crime, above the California and national averages, while arrests have dropped in half in recent years.”

The judge also upheld tighter eligibility for disability retirement and an elimination of the “13th check” bonus payment to retirees when investment earnings exceed the forecast. A mixed ruling on retiree health care allowed some cuts and rejected others.

Mayor Reed said the ruling protects $20 million in current budget savings from elimination of the bonus check and retiree health care changes. But the invalidation of parts of Measure B “highlights” the lack of flexibility in controlling retirement costs.

“That’s why I believe that we need a constitutional amendment that will empower government leaders to tackle their massive pension problems and negotiate fair and reasonable changes to employees’ future pension benefits,” he said in a news release.

Reed and others are proposing an initiative to put a constitutional amendment on the ballot that would give state and local governments the option of cutting pensions current workers earn in the future, while protecting pension amounts already earned.

A title and summary for the proposed initiative, based on a cost analysis by the nonpartisan Legislative Analyst’s Office, is being written by the office of state Attorney General Kamala Harris.

“Breaking the promise by eliminating the vested benefit rights of police officers and other public employees is a non-starter in the courts and with the public,” Dave Low, chairman of Californians for Retirement Security, said in a news release.

The leader of the labor coalition said the “more than $3 million in taxpayer dollars” spent on the Measure B legal battle will be the “tip of the iceberg of the legal costs” if the proposed initiative moves forward.

Low said Reed should join “nearly 400 leaders across the state” in negotiating cost-cutting agreements with unions. Reformers say not enough savings result from the typical agreement, higher worker pension contributions and lower pensions for new hires.

Warning that pension costs could “crush” government, the bipartisan Little Hoover Commission said in a 2011 report: “The Legislature should give state and local governments the authority to alter the future, unaccrued retirement benefits for current public employees.”

A pension reform approved by San Diego voters last year, Proposition B, was designed to bypass the vested rights issue. All new hires, except police, were switched from pensions to 401(k)-style individual investment plans.

For current workers the initiative called for a five-year freeze on pay used to calculate pensions. Unions agreed to the freeze, expected to reduce the $275 million city pension payment this year by $25 million, U-T San Diego reported.

But the city pension board declined to immediately include the freeze in cost projections, so current year savings were lost. The city retirement system has projected that Proposition B will save $949.5 million over 30 years.

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Private Sector

2013 End of Year Plan Sponsor "To Do" List
Part 3 – Qualified Retirement Plans

As 2013 comes to an end, we are pleased to present you with our traditional End of Year Plan Sponsor "To Do" Lists. This year, we are presenting our "To Do" Lists in three separate Employee Benefits Updates. Part one of the series covered executive compensation issues; part two covered health and welfare plan issues and part three will cover qualified plan issues. Each Employee Benefits Update will provide you with a "To Do" List of items on which you may want to take action before the end of 2013 or in early 2014. As always, we appreciate your relationship with Snell & Wilmer and hope that these "To Do" Lists focus your efforts over the next few months.

This Employee Benefits Update, part three of our End of Year Plan Sponsor "To Do" Lists, focuses on year-end qualified plan issues.

For your convenience, we have broken the "to do" lists into six categories.

All Qualified Plans "To Do" List

- Adopt Design Changes by the End of the Plan Year: If an employer made any design changes during the year, the plan generally must be amended to reflect those design changes by the last day of the 2013 plan year (i.e., December 31, 2013 for calendar year plans).
- Adopt Plan Restatement if in Cycle C: If a qualified plan is individually designed and falls in Cycle C (i.e., certain governmental plans or the employer identification number associated with the plan ends in 3 or 8) the plan must be restated and submitted for a determination letter on or before January 31, 2014.
- Update Summary Plan Description if needed: Summary Plan Descriptions (SPDs) must be updated once every five years if the plan has been amended during the five year period and once every 10 years for other plans.
- Consider Impact on Employee Benefit Plans of Supreme Court Defense of Marriage Act ("DOMA") Case: As reported in our September 9, 2013 Legal Alert, "Agencies Issue Guidance on Same Sex Marriage Impacting Employee Benefits," the Department of the Treasury and the Internal Revenue Service have released guidance on the treatment of same sex-spouses. In Revenue Ruling 2013-17, the IRS and Treasury ruled that same-sex married couples will be treated as married for all federal tax purposes as long as they were married in a jurisdiction that recognizes same-sex marriages, which is known as a "state of celebration" standard. The guidance also provides that the terms "spouse," "husband and wife," "husband" and "wife" include an individual married to a person of the same sex if the individuals are lawfully married under state law,

and the term "marriage" includes such a marriage between individuals of the same sex. Employers will need to update and amend their qualified plans and plan practices to treat same-sex and opposite-sex spouses the same under qualified retirement plans. This includes (1) offering both same-sex and opposite-sex spouses qualified joint and survivor annuities and qualified pre-retirement annuities, when applicable, (2) requiring spousal consent to beneficiary designations, (3) honoring qualified domestic relations orders and (4) complying with the required minimum distribution provisions.

- Review 2014 Plan Limits: Become familiar with the 2014 plan limits. See "Retirement Plan Limits for 2014" for more information.

Section 401(k) Plans "To Do" List

- Comply with Items on All Qualified Plans List: The items on the All Qualified Plans list also apply to Section 401(k) plans.
- Provide Section 401(k)/401(m) Safe Harbor Notice by December 2, 2013 for Calendar Year Plans: As a reminder, if a plan has a Section 401(k)/401(m) contribution safe harbor, an employer must provide the safe harbor notice at least 30 days, but not more than 90 days, before the beginning of each plan year (i.e., December 2, 2013 for calendar year plans).
- Provide Annual Automatic Enrollment Notice by December 2, 2013 for Calendar Year Plans: As a reminder, if a plan has an automatic contribution arrangement, an eligible automatic contribution arrangement ("EACA"), or a qualified automatic contribution arrangement ("QACA"), or any combination thereof, an employer must give an annual automatic enrollment notice at least 30 days, but not more than 90 days, before the beginning of each plan year (i.e., December 2, 2013 for calendar year plans).
- Provide Annual Qualified Default Investment Alternative Notice by December 2, 2013 for Calendar Year Plans: If an employer is relying on the qualified default investment alternative ("QDIA") safe harbor, it must give an annual notice at least 30 days, but not more than 90 days, before the beginning of each plan year (i.e., December 2, 2013 for calendar year plans).
- Provide Participant Fee Disclosure Information: Plans are required to provide a comparative chart of detailed investment-related information to plan participants and beneficiaries about the plan's designated investment alternatives on an annual basis. For calendar year plans, the initial fee disclosure was due on August 30, 2012. Department of Labor guidance requires this information to be provided at least annually. In an effort to allow plan sponsors to align this disclosure with other disclosure requirements, the Department of Labor issued Field Assistance Bulletin 2013-02, which provides plan administrators with a one-time opportunity to reset the deadline for the annual fee disclosure. Under this guidance, a plan administrator is treated as satisfying the annual notice requirement if the 2013 fee disclosure is provided no later than 18 months after the initial disclosure was provided (i.e., February 25, 2014). In addition, for plan administrators that have already taken action to furnish the 2013 fee disclosure, the one-time reset opportunity may be applied to the 2014 fee disclosure.

- Provide Participant Benefit Statements: Defined contribution plans must provide individual benefit statements at least annually, although plans that permit participants to direct the investment of their accounts must provide the statement at least quarterly. Defined contribution plans must also provide the statement upon request.
- Distribute Summary Annual Report: Employers should distribute a summary annual report, which is a summary of the information reported on the Form 5500. The summary annual report is generally due nine months after the plan year ends. If the Form 5500 was filed under an extension, the summary annual report must be distributed within two months following the date on which the Form 5500 was due.
- If Adding Qualified Automatic Contribution Arrangement or Eligible Automatic Contribution Arrangement for 2014, Adopt Amendment Before the 2014 Plan Year: Neither a QACA nor an EACA may be adopted mid-year. Accordingly, if an employer wishes to add a QACA or an EACA to its plan for the 2014 plan year, it must adopt an amendment by December 31, 2014 for calendar year plans.

Defined Contribution Plans (Other Than Section 401(k) Plans) “To Do” List

- Comply with Items on All Qualified Plans List: The items on the All Qualified Plans list also apply to defined contribution plans.
- Provide Annual Qualified Default Investment Alternative Notice by December 2, 2013 for Calendar Year Plans: If an employer is relying on the qualified default investment alternative (“QDIA”) safe harbor, it must give an annual notice at least 30 days, but not more than 90 days, before the beginning of each plan year (i.e., December 2, 2013 for calendar year plans).
- Provide Participant Fee Disclosure Information: Plans are required to provide a comparative chart of detailed investment-related information to plan participants and beneficiaries about the plan’s designated investment alternatives on an annual basis. For calendar year plans, the initial fee disclosure was due on August 30, 2012. Department of Labor guidance requires this information to be provided at least annually. In an effort to allow plan sponsors to align this disclosure with other disclosure requirements, the Department of Labor issued Field Assistance Bulletin 2013-02, which provides plan administrators with a one-time opportunity to reset the deadline for the annual fee disclosure. Under this guidance, a plan administrator is treated as satisfying the annual notice requirement if the 2013 fee disclosure is provided no later than 18 months after the initial disclosure was provided (i.e., February 25, 2014). In addition, for plan administrators that have already taken action to furnish the 2013 fee disclosure, the one-time reset opportunity may be applied to the 2014 fee disclosure.
- Provide Participant Benefit Statements: Defined contribution plans must provide individual benefit statements at least annually, although plans that permit participants to direct the investment of their accounts must provide the statement at least quarterly. Defined contribution plans must also provide the statement upon request.

- Distribute Summary Annual Report: Employers should distribute a summary annual report, which is a summary of the information reported on the Form 5500. The summary annual report is generally due nine months after the plan year ends. If the Form 5500 was filed under an extension, the summary annual report must be distributed within two months following the date on which the Form 5500 was due.

Defined Benefit Plans “To Do” List

- Comply with Items on All Qualified Plans List: The items on the All Qualified Plans list also apply to defined benefit plans.
- Post Portions of Form 5500 on Company’s Intranet: A plan sponsor of a defined benefit pension plan that maintains an intranet website for the purpose of communicating with employees (and not the public) is required to post portions of the defined benefit plan’s Form 5500 on the intranet.
- Comply with Annual Funding Notice to Participants: Single employer defined benefit plan sponsors must provide participants with an annual notice of the plan’s funding status within 120 days of the end of the plan year to which the notice relates. Plans with fewer than 100 participants do not have to provide the notice until the Form 5500 annual report is due for the plan year.
- Comply with Participant Notice Requirement if Adjusted Funding Target Attainment Percentage is less than 80%: In addition to the annual funding notice described above, Section 101(j) of ERISA requires a plan administrator to provide a notice to participants if the plan is subject to a restriction on payment of benefits. These restrictions become applicable if the plan’s adjusted funding target attainment percentage is less than 80%. Plan administrators are not required to provide this notice to participants and beneficiaries in pay status.
- Provide Participant Benefit Statements: Defined benefit plans should provide individual benefit statements every three years or upon request. Alternatively, defined benefit plans may satisfy the requirement by annually notifying participants that the pension benefit statement is available and how a participant may obtain such statement.
- Amend Plans to Comply with Funding-Based Benefit Restrictions of Section 436 of the Code: IRS Notice 2012-70 extended the deadline for plan sponsors to amend their plans to comply with Section 436 of the Internal Revenue Code of 1986, as amended (the “Code”), which imposes benefit restrictions on certain underfunded defined benefit pension plans. Plan sponsors now must amend their plans by the latest of (1) the last day of the first plan year that begins on or after January 1, 2013, (2) the last day of the plan year for which Section 436 is first effective for the plan or (3) the due date (including extensions) of the employer’s tax return for the tax year that contains the first day of the plan year for which Section 436 is first effective for the plan (i.e., December 31, 2013 for calendar year, non-collectively bargained plans).
- Provide Suspension of Benefits Notice, if applicable: If required by the terms of the plan, plan administrators must provide notice of the suspension of benefits to participants who continue employment beyond normal retirement age and to

rehired retirees. This notice should be given during the first month during which the benefit is suspended.

Section 403(b) Plans “To Do” List

- Adopt Design Changes by the End of the Plan Year: If an employer made any design changes to the plan during the year, it generally must amend its plan to reflect those design changes by the last day of the 2013 plan year (i.e., December 31, 2013 for calendar year plans).
- Update Summary Plan Description if Needed: Summary Plan Descriptions ("SPDs") must be updated once every five years if the plan has been amended during the five-year period and once every 10 years for other plans. If a Section 403(b) plan is subject to ERISA, the SPD may need to be updated.
- Comply with Form 8955-SSA Reporting Requirements: The Form 8955-SSA is the form that replaced the Schedule SSA of the Form 5500. The Form 8955-SSA reports information about plan participants with deferred vested benefits. Generally, the Form 8955-SSA is due by the last day of the seventh month after the plan year ends (subject to a 2 1/2-month extension).
- Provide Safe Harbor Notice by December 2, 2013 for Calendar Year Plans: As a reminder, if a Section 403(b) plan uses an ACP contribution safe harbor, an employer must provide the safe harbor notice at least 30 days, but not more than 90 days, before the beginning of each plan year (i.e., December 2, 2013 for calendar year plans).
- Provide Annual Automatic Enrollment Notice by December 2, 2013 for Calendar Year Plans: As a reminder, if a Section 403(b) plan is subject to ERISA and has automatic deferrals, an employer must give an annual automatic enrollment notice at least 30 days, but not more than 90 days, before the beginning of each plan year (i.e., December 2, 2013 for calendar year plans).
- Provide Annual Qualified Default Investment Alternative Notice by December 2, 2013 for Calendar Year Plans: As a reminder, if a Section 403(b) plan is subject to ERISA and an employer is relying on the qualified default investment alternative (“QDIA”) safe harbor, it must give an annual notice at least 30 days, but not more than 90 days, before the beginning of each plan year (i.e., December 2, 2013 for calendar year plans).
- Provide Participant Benefit Statements: Section 403(b) plans that are subject to ERISA must provide individual benefit statements at least annually, although plans that permit participants to direct the investment of their accounts must provide the statement at least quarterly. Plans must also provide the statement upon request.
- Distribute Summary Annual Report: Section 403(b) plans that are subject to ERISA must distribute a summary annual report, which is a summary of the information reported on the Form 5500. The summary annual report is generally due nine months after the plan year ends. If the Form 5500 was filed under an extension, the summary annual report must be distributed within two months following the date on which the Form 5500 was due.

- If Adding an ACP Contribution Safe Harbor for 2014, Adopt Amendment Before the 2014 Plan Year: ACP contribution safe harbors may not be adopted mid-year. Accordingly, if an employer wishes to add an ACP contribution safe harbor to its Section 403(b) plan for the 2014 plan year, it must adopt an amendment by December 31, 2013 for calendar year plans.
- Comply with Form 5500 Reporting Requirements: As a reminder, effective for plan years beginning on or after January 1, 2009, Section 403(b) plans subject to ERISA must comply with standard Form 5500 filing requirements, including an annual plan audit for large plans (i.e., plans with 100 or more participants) and detailed financial information for small Section 403(b) plans (i.e., plans with fewer than 100 participants).
- Last Chance to Correct Section 403(b) Written Plan Document Failure With a Reduced Fee: As reported in our February 7, 2013 Legal Alert, "Employee Benefits Update – The IRS Releases Revised Retirement Plan Correction Program," the Employee Plans Compliance Resolution System ("EPCRS") has been updated to, among other things, apply to Section 403(b) Plans. The new EPCRS provides that plan sponsors who failed to timely adopt a written 403(b) plan document before the December 31, 2009 IRS deadline may correct the plan document failure before the end of the year and pay a reduced EPCRS compliance fee. EPCRS compliance fees can be as high as $25,000 for plans with more than 10,000 participants. Plan sponsors that failed to adopt a written 403(b) plan document will benefit from a 50% reduction in the EPCRS compliance fee if they correct the failure prior to December 31, 2013.

Retirement Plan Limits for 2014

The key 2014 dollar amounts (compared to the 2013 dollar limits) are noted below.

The Social Security Administration separately announced the taxable wage base for 2013, which is noted at the end of the chart.

Maximum Qualified Retirement Plan Dollar Limits		
	2013	**2014**
Limit on Section 401(k) deferrals (Section 402(g))	$17,500	$17,500
Dollar limitation for catch-up contributions (Section 414(v)(2)(B)(i))	$5,500	$5,500
Limit on deferrals for government and tax-exempt organization deferred compensation plans (Section 457(e)(15))	$17,500	$17,500
Annual benefit limitation for a defined benefit plan (Section 415(b)(1)(A))	$205,000	$210,000
Limitation on annual contributions to a defined contribution plan (Section 415(c)(1)(A))	$51,000	$52,000
Limitation on compensation that may be considered by qualified retirement plans (Section 401(a)(17))	$255,000	$260,000
Dollar amount for the definition of highly compensated employee (Section 414(q)(1)(B))	$115,000	$115,000
Dollar amount for the definition of key employee in a top-heavy plan (Section 416(i)(1)(A)(i))	$165,000	$170,000
Dollar amount for determining the maximum account balance in an ESOP subject to a five-year distribution period (Section 409(o)(1)(C)(ii))	$1,035,000	$1,050,000
SIMPLE retirement account limitation (Section 408(p)(2)(E))	$12,000	$12,000
Social Security Taxable Wage Base	$113,700	$117,000

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Is age 70 retirement the 'new normal'?

If you think about a retirement benefit as an in-kind benefit – e.g., every employee needs enough money to replace 70-80% of her preretirement income – then the cost of providing that benefit has doubled in the last 13 years. Why? Because interest rates have declined by more than 400 basis points since 2000.

The impact of this change isn't subtle. A recent Employee Benefits Research Institute (EBRI) study found that, compared with historical returns, in a long-term low interest rate environment the number of workers that will "have sufficient retirement resources to cover 100% of the simulated retirement expenses" drops by about 10 percentage points. The impact is greater the longer the worker has to retirement: longer periods of low returns = lower benefits. And the impact is greater as you go up the income scale: (oversimplifying somewhat) Social Security benefits are largely unaffected by interest rate changes.

These results are intuitive. Obviously, they are very assumption-dependent: What is an adequate retirement income (EBRI uses an elaborate, bottom up model)? What are reasonable asset allocation and return assumptions (EBRI uses a 6% equity premium)? How do you determine 'real' values (basically, how do you account for inflation effects)? But there's no question, declining interest rates are squeezing retirement savings, and something has to give.

So, what's Plan B? In real life, there are a limited set of options. You can save more -- but with the cost of health care and education going up as well, it's hard to see exactly where the average worker is going to get the extra savings. You can decide to live on less. Or you can work longer. There aren't a lot of other choices.

Does working longer actually solve the problem? Maybe. A recent paper by the Center for Retirement Research found that "over 85% of households would be prepared to retire by age 70. Thus, many individuals will need to work longer than their parents did, but they will still be able to enjoy a reasonable period of retirement, especially as health and longevity continue to improve." That result also is intuitive: if you work longer you save more and earn more on your savings, and the period over which your savings have to be paid out is shorter.

But, there is a key, emerging element of retirement income adequacy that the CRR paper doesn't capture. In its paper CRR takes a 'replacement rate' approach to retirement income adequacy, generally defining adequacy in retirement as a percentage of preretirement income. This in effect assumes a 'smooth' rate of spending in retirement (e.g., the 78% preretirement income replacement target recommended by Aon Consulting and Georgia State University Replacement Ratio Study (2008)).

As an EBRI review of the CRR analysis points out, however, there are retirement expenses that are, in effect, fixed -- they don't go down just because you're working

longer and retiring less. As Americans live longer, end-of-life expenses – health care and, especially, long-term care – are becoming a bigger part of the 'adequacy equation.' Working longer doesn't reduce those costs, unless you work until you die.

Since implicit assumptions about inflation play such an important role in these analyses, it's worth considering it's impact on income, wealth and retirement adequacy. For someone living at a subsistence level (e.g., EBRI's bottom income quartile), current CPI numbers may make sense – they may reflect the actual impact of price changes on their lives. And, certainly, increases in the cost of education also have a direct effect on the wallets of those workers sending their kids to college.

But consider health care. How much of the increase in health care costs is just paying for better quality? Maybe that's a hard question to answer, but in other areas – most obviously, technology – it's an easy one. Some things really are getting cheaper. That is to say that what inflation means to you depends on what you're buying. And, thus, for some Americans, the 'real' (adjusted for inflation) rate of interest may actually be much higher than reported, because 'actual' inflation is much lower (even, perhaps, negative). Thus, for some, 'living on less' may not be all that bad.

It's conceivable that 'real' rates will go back up significantly and for the long term (they have moved up about 1% since 2012). However, historically low rates may be around for a while: our aging population and the world's demonstrated preference for the dollar vs. other currencies being two big reasons why. For many Americans, working longer will be a no-brainer – they may even enjoy it. Others may dislike work so much they will opt for living on less. Many will have to do both.

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Pyramis Survey Reveals Rising Risk Appetite Among Corporate U.S. Mid-Market Pension Plans, Despite Concerns

SMITHFIELD, RHODE ISLAND -- Despite risk management being their top concern and many with closed or frozen pensions, more than half (55%) of U.S. mid-market corporations stated they intend to maintain or increase their current risk profile, according to new research by Pyramis Global Advisors®, a Fidelity Investments® company and leading institutional multi-asset class investment manager with nearly $200 billion in assets under management and more than 600 institutional clients.

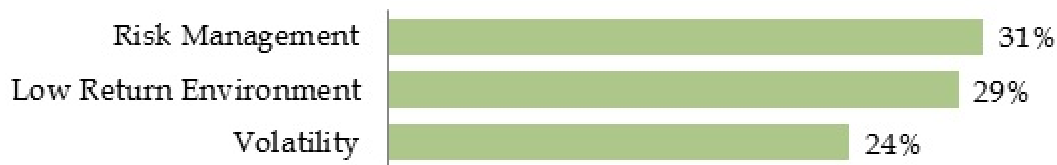
This was one of the key findings from 2013 Pyramis US Corporate Mid-Market Pulse Poll. In September and October 2013, Pyramis Global Advisors surveyed executives from 166 mid-sized corporations to better understand the concerns, challenges and future intentions for their defined benefit plans. The pensions these executives

represent, which range from $50 million to $500 million, cumulatively total more than $32 billion in assets under management.

In addition to risk management, survey respondents cite two other top concerns related to their investment portfolios: a low return environment and market volatility. The Pyramis survey also reveals that while the majority of corporate mid-market pensions plan to maintain or increase their risk profile, nearly one-third (30%) plan to implement a de-risking strategy but have not established the criteria (e.g., improvement in funding status, rise in interest rates) for doing so. An additional 15 percent of plans also intend to de-risk, but already have a formal de-risking strategy with established criteria in place.

“While risk management is stated as a top concern, the combination of rising equity markets and an unprecedented low return environment is motivating investors to consider increasing risk to generate higher returns,” said Chuck McKenzie, head of Institutional Solutions, Pyramis Global Advisors. “That said, by taking on more risk, investors need to remain diligent about plan oversight, including the potential impact on their funding status in the event of a market decline.”

FIGURE 1: What is your top concern regarding your investment portfolio?



Matching Assets and Liabilities is Key Challenge

The biggest challenge in the investment decision-making process cited by mid-market pension plans is matching assets and liabilities (31%), followed by controlling costs (27%) and executing timely investment decisions (13%). The asset liability matching challenge is also reflected in the results that show, while many have a desire to de-risk, only 25 percent of survey respondents currently hedge their pension liabilities through a Liability Driven Investing (LDI) strategy.

FIGURE 2: What is the greatest challenge with your investment decision making process?

The Pyramis survey reveals that for plans that aspire to de-risk, the leading event to initiate a de-risking program would be an improvement in their plans' funding status, cited by one third (32%) of respondents. This is followed by a rise in interest rates (17%) and a shift in focus to managing volatility (15%). Nearly one in six (16%) indicated nothing would cause them to adopt a de-risking program.

Pyramis Publishes New Liability Transfer Paper

Pyramis recently launched a new report on pension & longevity risk, "Liability Transfer Using Annuity-in-Kind Portfolios: An Effective Risk-Management Approach for Plan Sponsors." The paper explains how defined benefit pension plans can reduce risk through permanent liability transfers.

Lack of Time and Resources

According to the Pyramis survey, 61 percent of respondents say the time spent overseeing all aspects of defined benefit plans has increased over the past five years, and nearly two-thirds (71%) of those respondents expect this trend to continue. Regulatory and accounting changes take up the most time (40%), followed by actuarial modeling (31%).

FIGURE 3: What aspect of your defined benefit plan has consumed the most time over the past 12 months?

To help overcome the time management challenge, it is no surprise that the vast majority (81%) of U.S. corporate mid-market plans use a consultant for manager selection, asset allocation, risk oversight or performance review. However, an additional 49% of survey respondents have also entered into an outsourced chief investment officer (OCIO) arrangement.

"Driven by a lack of plan resources and expertise, many institutional investors are recognizing that external managers, particularly those that manage multi-asset class strategies, may be better positioned to evaluate and execute asset allocation decisions to help generate more consistent returns and manage risk," said McKenzie.

Mid-Market Pensions Increase Global Investments, Reduce Domestic Market Exposure

U.S. mid-market pension plans expect to increase their allocation to emerging market and global investments in the next one to two years, while reducing exposure to domestic markets. The Pyramis survey reveals that plans sponsors expect net increases to their asset allocations: emerging market equity (17%), global equity (16%), liquid alternatives (12%), emerging market debt (10%), illiquid alternatives (9%), global fixed income (7%) and U.S. fixed income (2%). Conversely, one in 10 (8%) say they will decrease net U.S. equity allocation and leave exposure to non-U.S. developed market equity unchanged.

Funding Status Improves, End States Remain Uncertain

Driven mainly by rising equity markets, funding status among U.S. corporate mid-market plans has improved, with 55 percent funded at 90 percent or better, and among them 21 percent funded at 100 percent or more. But uncertainty around the end status of mid-market plans remains an issue, with 24 percent of respondents stating that they are undecided on the end state of their defined benefit plan (e.g., remain open to new and existing employees, freeze, close to new employees but accrue for existing participants, terminate).

About the Survey

In September and October 2013, Pyramis conducted an online survey of US corporate mid-market institutional investors. The 166 respondents have plan assets under management between $50 million and $500 million. The cumulative assets under management represented by respondents totaled more than $32 billion. The survey was executed in association with the Asset International, publisher of PLANSPONSOR magazine and aiCIO magazine. Investment, executive or HR benefits and plan administrators responded to an online questionnaire1. A report on the survey is available at www.pyramis.com/us/mid-market.

About Pyramis Global Advisors

Pyramis Global Advisors, a Fidelity Investments company, delivers asset management products and services designed to meet the needs of institutional investors around the world. Pyramis is a multi-asset class manager with extensive experience managing investments for, and serving the needs of, some of the world's largest corporate and public defined benefit and defined contribution plans, endowments and foundations, insurance companies, and financial institutions. The firm offers traditional long-only and alternative equity, as well as fixed income and real estate debt and REIT investment strategies. As of Sept. 30, 2013, assets under management totaled nearly $200 billion

USD. Headquartered in Smithfield, RI, USA, Pyramis offices are located in Boston, Toronto, Montreal, London, and Hong Kong.

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Preview of 2014 Lump Sum Interest Rates

As mentioned in our July lump sum interest rate post, many defined benefit (DB) plan sponsors are considering lump sum payouts to their terminated vested participants as a way of "right-sizing" their plan. The ultimate goal is to reduce plan costs and risk. The IRS recently released the November 2013 417(e) rates, which will be the 2014 reference rates for many DB plans. This post shares a brief update of the impact these rates could have on 2014 lump sum payout strategies.

Background

DB plans generally must pay lump sum benefits using the larger of two plan factors:

(1) The plan's actuarial equivalence; or

(2) The 417(e) minimum lump sum rates.

Since interest rates have been so low over the past few years, the 417(e) rates are usually the lump sum basis. In particular, 2013 lump sums were abnormally expensive due to historically low interest rates at the end of 2012 (the reference rates for 2013 lump sum calculations). This is because lump sum values increase as interest rates decrease and vice versa.

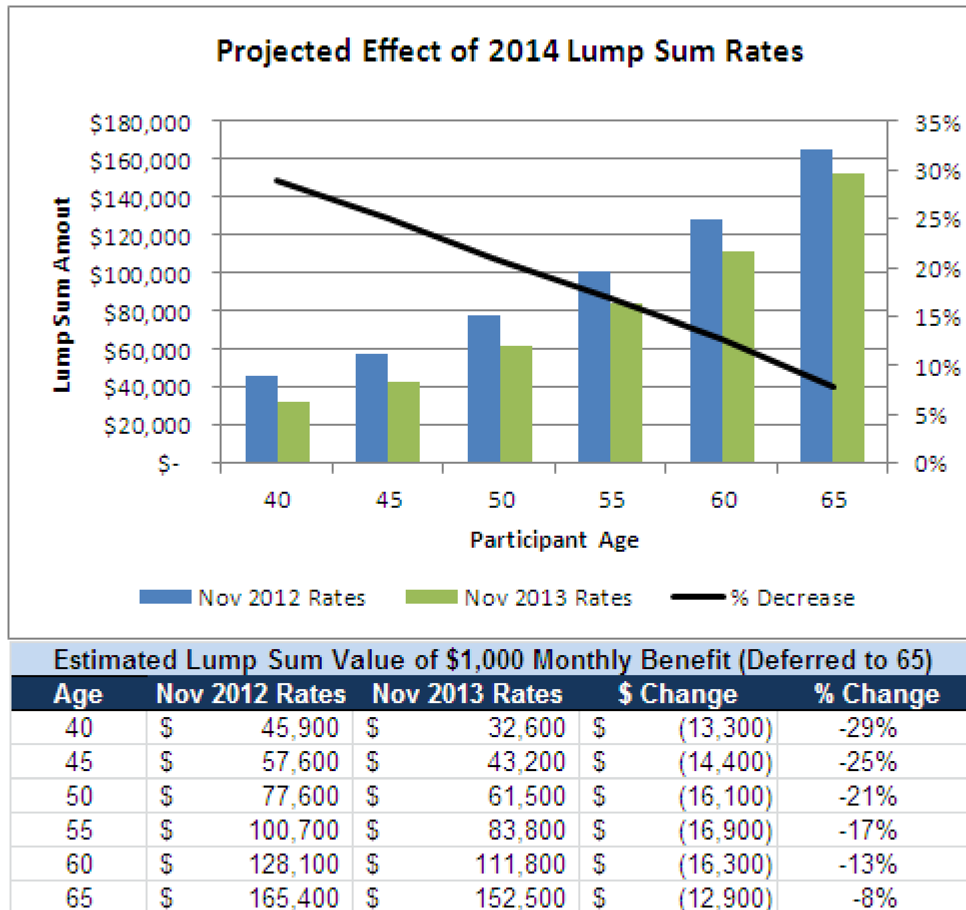
Effect of Interest Rate Changes

For calendar year plans, the lookback month for the 417(e) rates is often a couple of months before the start of the plan year. Here's a comparison of the November 2012 rates (for 2013 payouts) versus the November 2013 rates (for 2014 payouts).

417(e) Interest Rates		
Segment	November 2012	November 2013
Segment 1	0.97%	1.19%
Segment 2	3.50%	4.53%
Segment 3	4.60%	5.66%

November 2013 segment rate table

As we can see, all three segments have increased substantially since last November. So, what's the potential impact on lump sum payments? The table and chart below show the difference in lump sum value at sample ages assuming payment of deferred-to-65 benefits using the November 2012 and November 2013 417(e) interest rates.



Estimated Lump Sum Value of $1,000 Monthly Benefit (Deferred to 65)				
Age	**Nov 2012 Rates**	**Nov 2013 Rates**	**$ Change**	**% Change**
40	$ 45,900	$ 32,600	$ (13,300)	-29%
45	$ 57,600	$ 43,200	$ (14,400)	-25%
50	$ 77,600	$ 61,500	$ (16,100)	-21%
55	$ 100,700	$ 83,800	$ (16,900)	-17%
60	$ 128,100	$ 111,800	$ (16,300)	-13%
65	$ 165,400	$ 152,500	$ (12,900)	-8%

Note: If we adjust for the fact that participants will be one year older in 2014 (and thus one fewer years of discounting), then this decreases the savings by about 5% at most ages.

Lump Sum Strategies

So, what else should plan sponsors consider?

1. If you haven't already considered a lump sum payout window, the 2014 lump sum rates may make this option much more affordable than in 2013.

2. With the scheduled increase in PBGC flat-rate and variable-rate premiums due to MAP-21 (plus the proposed additional premium increases in the Bipartisan Budget Act of 2013) there's an incentive to "right-size" a pension plan to reduce the long-term cost of PBGC premiums.

3. In addition to lump sum payout programs, plan sponsors should consider annuity purchases and additional plan funding as ways to reduce long-term plan costs/risks

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ADDITIONAL INFORMATION ON 2013 LONG TERM PROJECTIONS FOR SOCIAL SECURITY:

Speaking about Social Security, The United States Congressional Budget Office has issued "The 2013 Long-Term Projections for Social Security: Additional Information." Social Security is the federal government's largest single program. Of the 58 million people who currently receive Social Security benefits, 70% are retired workers or their spouses and children, and another 11% are survivors of deceased workers; all of those beneficiaries receive payments through Old-Age and Survivors Insurance. The other 19% of beneficiaries are disabled workers or their spouses and children; they receive Disability Insurance benefits. In fiscal year 2013, Social Security's outlays totaled $808 billion, almost one-quarter of federal spending; OASI payments accounted for 83% of those outlays, and DI payments made up 17%. Each year, CBO prepares long term projections of revenues and outlays for the program. The most recent set of 75-year projections was published in September 2013. This publication presents additional information about those projections. Social Security has two primary sources of tax revenues: payroll taxes and income taxes on benefits. Roughly 96% of those revenues derive from a payroll tax --generally, 12.4% of earnings -- that is split evenly between workers and their employers; self-employed people pay the entire tax. The payroll tax applies only to taxable earnings -- earnings up to a maximum annual amount ($113,700 in 2013). The remaining share of tax revenues – 4% is collected from income taxes that higher income beneficiaries pay on their benefits. Revenues credited to the program totaled $745 billion in fiscal year 2013. Revenues from taxes, along with intra-governmental interest payments, are credited to Social Security's two trust funds, one

for OASI and one for DI, and the program's benefits and administrative costs are paid from those funds. Although legally separate, the funds often are described collectively as the OASDI trust funds. In a given year, the sum of receipts to a fund along with the interest that is credited on balances, minus spending for benefits and administrative costs, constitutes that fund's surplus or deficit. In calendar year 2010, for the first time since the enactment of the Social Security Amendments of 1983, annual outlays for the program exceeded annual tax revenues (that is, outlays exceeded total revenues excluding interest credited to the trust funds). In 2012, outlays exceeded noninterest income by about 7%, and CBO projects that the gap will average about 12% of tax revenues over the next decade. As more members of the baby boom generation retire, outlays will increase relative to the size of the economy, whereas tax revenues will remain at an almost constant share of the economy. As a result, the gap will grow larger in the 2020s and will exceed 30% of revenues by 2030. CBO projects that under current law, the DI trust fund will be exhausted in fiscal year 2017, and the OASI trust fund will be exhausted in 2033. If a trust fund's balance fell to zero and current revenues were insufficient to cover the benefits specified in law, the Social Security Administration would no longer have legal authority to pay full benefits when they were due. In 1994, legislation redirected revenues from the OASI trust fund to prevent the imminent exhaustion of the DI trust fund. In part because of that experience, it is a common analytical convention to consider the DI and OASI trust funds as combined. Thus, CBO projects, if some future legislation shifted resources from the OASI trust fund to the DI trust fund, the combined OASDI trust funds would be exhausted in 2031. The amount of Social Security taxes paid by various groups of people differs, as do the benefits that different groups receive. For example, people with higher earnings pay more in Social Security payroll taxes than do lower earning participants, and they also receive benefits that are larger (although not proportionately so). Because Social Security's benefit formula is progressive, replacement rates -- annual benefits as a percentage of average annual lifetime earnings -- are lower, on average, for workers who have higher earnings. As another example, the amount of taxes paid and benefits received will be greater for people who were born more recently because they typically will have higher earnings over a lifetime, even after an adjustment for inflation.

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