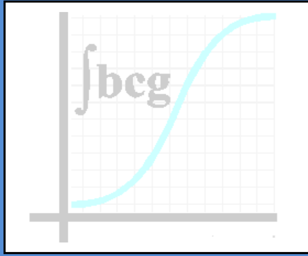

BCG Retirement News Roundup

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

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

We review numerous industry news services daily and will include a collection of timely and significant articles each month concerning compliance, actuarial plan costs (including assumption debates), plan design change issues and benefit trends, as well as other related topics. If you would like to discuss any of these issues, please contact us.

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Public Sector/Government Plans

House axes pension bill, killing budget deal

A proposal to revamp Pennsylvania's two large public-sector pension systems was defeated overwhelmingly Saturday in the state House, collapsing a deal to solve the state's 6-month-old budget impasse.

The House voted 149-52 against a bill that would force newly hired teachers and state workers into a hybrid system made up of a traditional pension along with a 401(k)-style benefit. Every Democrat voted against the bill, along with a majority of Republicans.

House Majority Leader Dave Reed, R-Indiana, who argued strongly in favor of the bill, said the next move will be to advance a stopgap budget. He said the pension changes were needed to address costs that have been increasing for school districts and state government.

"If that's not possible, then new revenue is off the table as well, and we're going to have to plan accordingly," Reed told reporters after the vote. "It just went down pretty resoundingly."

A stopgap budget may be a tough sell in the Senate. Majority Leader Jake Corman, R-Centre, said the next move should be for the House to send over a full-year budget without any tax increases.

Democratic Gov. Tom Wolf said Saturday he's against a stopgap measure that could help cash-squeezed schools and government agencies in the near term.

Layoffs in state government could soon occur, Corman said, warning that a deadline is also approaching for the Educational Improvement Tax Credit program that funds private school scholarships.

"This is real — there's consequences to not being able to get things done," Corman said.

Rep. John McGinnis, R-Blair, argued on the floor that the proposal would have actually increased the state's pension debt and that the Legislature should instead look to completely end the defined-benefit, traditional pension.

"We like to think that this is an honorable institution," McGinnis said. "But by underfunding our pensions, we steal from children and from children not yet born. How is that honorable?"

The bill would have been a step in the right direction, said Rep. Mike Tobash, R-Schuylkill, by shifting half the investment risk to the new hires and off the backs of taxpayers.

"This bill does not kick the can down the road," Tobash said. "In fact, it forces our pension systems to get a sharper pencil and safe money on investment fees."

The pension changes were part of a framework that Wolf had negotiated with the Republican-controlled General Assembly, along with higher taxes to increase education funding and reforms to the state-controlled system of selling wine and liquor.

Wolf said Friday that he had obtained enough votes to get the taxes through the House, but the pension bill's defeat pre-empted a tax vote. His office had no immediate comment on the vote Saturday.

Pennsylvania has been without a budget since the start of July, leaving schools and government agencies scrambling to pay bills.

The vote represents a win for unions that represent teachers and government workers, as well as for those who fought the tax increase.

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Connecticut at forefront of pension innovation

Who would have thought it?

Connecticut is on the cutting edge of pension innovation on two fronts: 1) it is one of a handful of states leading the charge to set up a state-run, auto-IRA program for its uncovered private sector workers; and 2) the governor has proposed an innovative plan to address its seriously underfunded pension plans. Since the state initiatives for the uncovered have received a lot of publicity, this blog post focuses on the second innovation.

Connecticut's two largest retirement systems are the State Employees Retirement System (SERS), and the Teachers' Retirement System (TRS). Over the past decade the state has made a concerted effort to improve funding.

Since 2001, the State has paid, on average, 90 percent of the annual required contribution (ARC) for SERS. For TRS, the State issued $2 billion in pension obligation bonds in 2008 and has paid 100 percent of the ARC since then. Prior to that, TRS funding was less consistent; the State paid more than 80 percent of the ARC from 2001 to 2003, close to 70 percent in 2004 and 2005, and essentially 100 percent in 2006 and 2007.

However, despite those efforts, the funded status for both these systems declined by about 20 percentage points and, as of 2014, stood at 42 percent for SERS and 59 percent for TRS –

among the lowest in the nation. The State requested that the Center for Retirement Research provide an assessment of both SERS and TRS.

The assessment showed that these plans were behind the eight ball from the beginning. They had promised benefits from 1939 but did not begin to fund their plans until the 1970s and 1980s.

Once Connecticut did start funding its plans, it did not do a very good job. A systematic analysis of actuarial valuations showed that the state consistently made inadequate contributions to both plans. These inadequate contributions were a combination of using a lax methodology for determining the annual required contribution and then failing to pay even that modest amount. In addition, actual investment returns fell short of the assumed rate after 2000.

As a result of significant underfunding, the majority of pension costs for the State going forward is due to the unfunded liability. These payments are very large and have the potential to crowd out other essential spending. Hence, Connecticut was interested in alternatives.

The two main options were to: 1) replace the 2032 full-funding date with a reasonable rolling amortization period; or 2) separately finance benefits for members hired before pre-funding began in the 1970s and 1980s. The rationale for both approaches is that the existing unfunded liability was accumulated over multiple generations and is primarily for the benefits of members hired before the state started to fund its pensions; it is not fair to place the entire burden of paying off these benefits on a single generation.

Under either approach, the state would improve the funding process going forward by switching to a level-dollar approach to amortize the unfunded liability and by reducing the assumed rate of return used to discount promised benefits.

The Governor has proposed to pay the benefits for Tier 1 retirees in SERS on a pay-as-you go basis. Tier I benefits were replaced by less generous Tier II benefits in 1985 for new hires, and 93 percent of the Tier 1 participants are retired, so Tier 1 retirees form an easily identifiable group.

A pay-as-you-go approach for benefits that arose before the state started to fund has a number of advantages. First, it stretches out payments over the longest period possible, providing the greatest generational equity. Second, it changes a malleable obligation into a fixed one; whereas the State faces no sanction for not making its full annual required contribution to the pension fund, the benefit payments must be paid each year by law. Third, pay-as-you-go makes the payment schedule fairly predictable, as it is unaffected by future changes in interest rates and/or investment returns. Finally, separately financing benefits for members hired before pre-funding also clarifies that the cost of benefits for current workers is modest.

While the proposal to pay retirees on a pay-as-you-go basis has created a political firestorm and the details need to be worked out, the approach makes enormous sense and could be very useful to other states that started the funding game with a large unfunded liability.

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Older workers seek options to scale back; Many look to reduce long hours, phase out to retirement.

Nurse Sally Korth , 65, has spent almost 40 years in the health care industry but recently took a new job, for significantly less pay, and recently scaled back her hours to four days per week.

Roberton Williams' plan was to retire on his government pension and take a part-time job to make up the difference in salary. It didn't quite work out that way.
Williams, 68, did retire but then started another full-time job with the Tax Policy Center, a Washington think tank.

"The plan was to work full time just until I got my feet wet," Williams said. "But, I ended up working full time for the next nine years."

He's far from an aberration. Many aging baby boomers are caught between a desire to work less and a labor market that just isn't ready to let them go.

According to the Bureau of Labor Statistics, 17.7 percent of people 65 and older are still working in some capacity, compared with 11.7 percent in 1995.

Of course, part of this increase could be due to a growing fear felt by many Americans about financial insecurity during retirement. Survey data has shown that fears about outliving one's savings are factoring into retirement planning. That is even prompting 34 percent of workers age 60-plus to say they plan on working until they die, or are too sick to work, according to a recent Wells Fargo survey.

Some workers just want a gradual transition, whether for financial reasons or just to keep working jobs where they can still contribute and help train the next generation.
Slightly more than 40 percent of U.S. workers hope to cut back hours or transition to a less demanding position before retirement, according to a 2015 report from the Transamerica Center for Retirement Studies.

One option offered by a small number of employers is "phased retirement," which allows retiring workers to go part time while also mentoring their incoming replacement, providing for a smoother transition. The Society for Human Resource Management puts the number at 8 percent.

In other cases, employers are eschewing formal arrangements in favor of short-term contracts.

"One thing we see is that employers are increasingly able to tap into a more flexible labor market, rather than going through formal HR structures," says Jean Setzfand, AARP's senior vice president of programs. "So having hard-and-fast rules for this can be difficult."
For federal workers, Congress passed legislation in 2012 creating a phased-retirement program, and the Office of Personnel Management, or OPM, formalized the rules last year.
To date, OPM has only finalized 16 applications for phased retirement from workers at the Library of Congress, NASA, the Broadcasting Board of Governors and the Energy Department. It expects to soon receive 12 more from the Smithsonian Institution that's from a federal workforce where 45 percent of employees are aged 50 or over.

OPM has stressed that it is up to individual federal agencies to decide when and if they will offer a phased-retirement option to their employees.

Tancred Lidderdale, 62, is one of the initial 16 who chose phased retirement. He works for the Energy Department as an economic forecaster, applying highly complex mathematical models to oil and gas markets. He's had an integral part in building these models over the past two decades.

"I know our agency would miss me," Lidderdale said. "They knew I was thinking about retirement and mentioned this option as a way to help pass on what I know before I leave." Lidderdale will work part time for the next two years. But, after nearly three years of waiting, many other federal workers are wondering if the program will even arrive in time for them.

"We have people with over 35 years of experience waiting to retire here, and it's a shame that many of them could walk out the door without the ability to pass that knowledge," says David Maxwell, 64. Maxwell is an air quality specialist with the Bureau of Land Management. Maxwell says if the bureau does offer the program, he'd be interested.
In a statement BLM says the Interior Department recently issued guidance and "expects to complete a draft phased-retirement policy by the spring of 2016."
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GASB addresses fiduciary activities, asset retirement obligations, pension issues

GASB proposed new accounting and financial reporting guidance Tuesday related to fiduciary activities, certain asset retirement obligations, and pension issues.

The proposals were contained in three separate exposure drafts—Fiduciary Activities, Certain Asset Retirement Obligations, and Pension Issues.

"These proposals are designed to improve consistency, comparability, and clarity in governmental accounting and financial reporting," GASB Chairman David Vaudt said in a news release.

Fiduciary Activities

In Fiduciary Activities, GASB proposes guidance regarding what constitutes fiduciary activities for reporting purposes, the recognition of liabilities to beneficiaries, and how fiduciary activities should be reported. The proposal would apply to all state and local governments. GASB seeks comment by March 31.

This exposure draft seeks to enhance the consistency and comparability of fiduciary activity reporting by state and local governments. Currently, governments are required to report fiduciary activities in fiduciary fund financial statements. But diversity in practice persists because existing standards do not explicitly state what constitutes a fiduciary activity for financial reporting purposes, according to GASB.

The proposal also is designed to improve the usefulness of information about fiduciary activity, providing a means for assessing the accountability of governments in their roles as fiduciaries.

Certain Asset Retirement Obligations

In Certain Asset Retirement Obligations, GASB proposes guidance for determining the timing and pattern of recognition for liabilities related to asset retirement obligations and corresponding deferred outflows of resources. An asset retirement obligation is a liability that is legally enforceable and associated with the retirement of a tangible capital asset, such as the decommissioning of a nuclear reactor. GASB seeks comment by March 31.

The proposal is designed to make financial statements more comparable by establishing uniform criteria for governments to recognize and measure asset retirement obligations, including obligations that previously may not have been reported.

Under the proposal, a government that is legally obligated to perform future asset retirement activities related to its tangible capital assets would be required to recognize a liability and a corresponding deferred outflow of resources. The proposal provides guidance on whether and when these transactions should be recognized.

The proposal also would require disclosures related to these asset retirement obligations.

Pension Issues

In Pension Issues, GASB addresses practice issues raised during the implementation of Statements No. 67, Financial Reporting for Pension Plans, and No. 68, Accounting and Financial Reporting for Pensions. Comment is sought by Feb. 12.

The objective of the proposal is to improve consistency in application of the standards. The proposal would address issues regarding:

- Presentation of payroll-related measures in required supplementary information.
- Selection of assumptions and the treatment of deviations from the guidance in Actuarial Standards of Practice for financial reporting purposes.
- Classification of payments made by employers to satisfy employee contribution requirements

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State's pension fund woes could mean higher taxes, audit report says

Higher state and local taxes, cuts in public services or a combination could be needed to shore up South Carolina's underfunded pension system for teachers and other public employees, according to a new Legislative Audit Council report.

The 80-page document released Monday says that despite requiring public employees and local governments to contribute more money in recent years, South Carolina's retirement funds have "been significantly underfunded for more than a decade and are projected to remain underfunded for more than 30 years."

In other words, investment gains, plus contributions from employees and employers, are unlikely to be enough to pay promised benefits.

S.C. House Speaker Jay Lucas, who was among lawmakers who requested the audit, said he wants comprehensive pension reform to be a priority next year. S.C. Treasurer Curtis Loftis said the report validates concerns he's been raising about the pension funds for four years.

More than 261,000 employees currently contribute to the two main pension plans.

"Thousands of South Carolinians have voluntarily contributed to this program, and their hard-earned dollars should always be managed in a way that produces the highest return possible," said Lucas, R-Hartsville.

Seeking higher investment returns, South Carolina has taken on more risk with pension money since 2007, when the state lifted a restriction on how the funds could be invested. What the state got in return, however, was high fees and investment returns that trailed most states, the report shows.

“Besides performing below its target, South Carolina’s portfolio performs below those of most other public pensions,” the audit report said.

Missing the target

The state anticipated the pension funds would earn a 7.5 percent return yearly, but over the past decade the average was 5.2 percent. A seemingly small difference, compounded year after year, adds up to lots of money for a system that needs another $21.5 billion to pay promised retirement benefits over time.

The audit report said the shortfall may be larger than reported, and could grow once longer life spans are recalculated. The Public Employee Benefit Authority, which administers the pensions, said in a written response that it “had not understated the state’s public pension liabilities.”

High fees have also chewed away at South Carolina’s underperforming pension funds.

The Legislative Audit Council compared the state’s pension funds to the Vanguard Balanced Index Fund, a mutual fund made up of 60 percent stocks and 40 percent bonds, operated by one of the world’s largest retirement fund companies.

In 2005, the state’s pensions had low costs and returns similar to the Vanguard fund, but in the following years the state’s performance was worse, and the state’s costs soared.

Due to South Carolina’s increase in stocks and “alternative investment” holdings, such as hedge funds, from 2005 to 2014, annual expenses rose from $22.4 million to $467.3 million. In 2005, expenses amounted to less than one-tenth of a percent of the pension assets — .09 percent, the same as the Vanguard fund. The state’s expenses rose to 1.57 percent by 2014.

High costs, low returns

“The General Assembly should consider amending state law to limit the maximum percentage of alternative investments in the state-administered pension portfolio,” the audit report said.

Additional recommendations called for lawmakers to bar Retirement System Investment commissioners from directly or indirectly choosing investments, and to end the practice of allowing “placement agents” to broker deals between investment funds and the RSIC.

Solicitations of investment fund companies by placement agents seeking commissions led to a State Law Enforcement Division investigation of “pay to play” allegations in 2012, but no wrongdoing was found.

South Carolina’s pension system is administered by the Public Employee Benefit Authority and assets are invested by the Retirement System Investment Commission.

At the end of June 2014, the fund had $29.9 billion in assets.

In written responses to the Legislative Audit Council report, the benefit authority and the investment commission said that some of the issues in the report were addressed by pension system changes and related legislation in 2012.

The state made substantial changes to the way employees hired after July 1, 2012, accrue pension benefits, closed a particularly lucrative pension arrangement for state lawmakers, reduced the expected rate of return for pension investments and reduced the minimum cost-of-living benefit increase.

Since 2012, employee and employer contribution rates for the main pension system have increased, to 8.16 percent and 11.06 percent of pay, respectively.

The employer is often a town, city or school district, and those higher employer costs are passed on to taxpayers.

Loftis told a state panel in November that South Carolina’s largest problem is the pension fund shortfall.

“I know there’s a lot of talk about roads, infrastructure and schools, but I would not be surprised if the pension didn’t eclipse all of that this year,” he said.

Michael Hitchcock, CEO of the Retirement System Investment Commission, said it is implementing several changes, such as reporting fees more transparently and adding more investment disclosures.

However, in a written response to the Legislative Audit Council, he said preventing commissioners from recommending investments could “inhibit” commissioners from sharing “attractive opportunities in the market they are seeing ... in which they have no interest.”

Lucas said the audit report “gives the General Assembly a starting point to offer assistance to the (commission) by helping them institute corrective measures that will put South Carolina’s pension plan on a path to solvency,” Lucas said.

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Private Sector

Reportable Event Changes for Pension Plans Effective January 1, 2016

Effective January 1, 2016, the Pension Benefit Guaranty Corporation (PBGC) altered the reportable event rules for defined benefit pension plans. Under new final regulations, the PBGC substantially reduced the reporting requirements for pension plan administrators, sponsors and contributing employers. In fact, the PBGC estimates that the final regulations will allow 82 percent of pension plans with more than 100 participants to utilize a reporting waiver.

As a background, the reportable event rules require pension plan administrators, sponsors and contributing employers to notify the PBGC either 30 days before or 30 days after a specified event occurs, including events such as extraordinary dividends or stock redemptions; changes in the controlled group or plan sponsor; termination or partial termination of a pension plan; active participant reductions; loan default; distributions to substantial owners; missed contributions; inability to pay benefits when due; application for a minimum funding waiver; insolvency; and transfers of benefit liabilities. The new rules, however, reduce the reporting burden in many of these circumstances. PBGC reporting now is automatically waived for certain reportable events if any of the following conditions are met: (1) the well-funded plan waiver, (2) the public company waiver, (3) the low-risk default waiver, and (4) small plan, foreign entity and de minimis waivers. In addition to these waivers, the new PBGC rules modify the definition of certain events that must be reported, and require electronic filing of all event notices. These new reportable event rules apply to post-event reports for events occurring on or after January 1, 2016, and apply to advance reports due on or after January 1, 2016.

Well-Funded Plan Waiver

During the plan year in which certain reportable events occur, a pension plan may utilize this waiver if no variable rate premium is due for the plan year prior to the reportable event. Generally, only a pension plan that is fully funded on an on-going basis (without smoothing) can avoid paying a variable rate premium to the PBGC. For example, if a pension plan does not pay a variable rate premium in 2016, the plan qualifies for the well-funded plan waiver for reportable events that occur in 2017 even if the plan is required to pay a variable rate premium in 2017.

Public Company Waiver

The public company waiver is available for certain reportable events if any contributing employer to the plan is a public company and files a SEC Form 8-K disclosing the reportable event. The waiver does not apply if the SEC Form 8-K disclosure is made under Item 2.02

(results of operations and financial condition) or under Item 9.01 (financial statements and exhibits).

Low-Default Risk Waiver

The low-default risk waiver is based on financial metrics that are readily available for most employers that contribute to a pension plan. Specifically, a pension plan's contributing employer and highest level U.S. parent (collectively, the company) can satisfy the low-default risk waiver for certain reportable events if either: (1) the company meets both of the first two below factors, or (2) the company meets at least four of the below seven factors:
The probability that the company will default on its financial obligations is not more than four percent over the next five years or not more than .4 percent over the next year, based on widely available financial information of credit worthiness
The company's secured debt (with some exceptions) does not exceed 10 percent of its total asset value
The company's ratio of total-debt-to-earnings before interest, taxes, depreciation and amortization (EBITDA) is 3.0 or less
The company's ratio of retained-earnings-to-total-assets is .25 or more
The company has positive net income for the two most recent completed fiscal years
The company has not experienced any loan default event in the past two years, regardless of whether reporting was waived
The sponsor has not experienced a missed contribution event in the past two years unless reporting was waived

The company must meet these factors during its annual financial reporting cycle, which generally begins on the date of a U.S. public company's 10-K filing, the closing date of a non-public company's accounting period for its audited or unaudited annual financial statements, and the date of the company's IRS Form 990 filing if there are no annual financial statements. The cycle then ends either on the earlier of the company's next financial reporting date or after 13 months. For example, assume a non-public U.S. company completes its audited financial statements on March 15, 2016, for the preceding calendar year. This company can rely on these financial statements to meet the low-default risk waiver during the period starting on March 15, 2016, and ending on April 15, 2017, provided that the audited financial statements for the company's fiscal year are available only after April 15, 2017.

Small Plan, Foreign Entity and De Minimis Waivers

For certain events, the PBGC's new regulations provide additional waivers for small pension plans with 100 or fewer participants and for foreign entities, if the foreign entity is not a direct or indirect parent of the contributing employer of the pension plan. Likewise, an entity that constitutes a de minimis percentage of the overall controlled group does not need to report certain events, where the entity: (1) has revenue that is 10 percent or less of the controlled

group's revenue; (2) has annual operating income that does not exceed the greater of $5 million or 10 percent of the controlled group's annual operating income; and (3) has tangible net assets at the end of the fiscal year that does not exceed $5 million or 10 percent of the controlled group's net tangible assets.

Changes to Reportable Event Definitions

The final regulations also make a number of changes to the rules for determining whether and when a reportable event occurs. Some of these changes include the following:
An active participant reduction now occurs either by attrition during a plan year or rapidly due to a reorganization, discontinuance of an operation, natural disaster, mass layoff or an early retirement incentive program. The reporting deadline for a rapid active participant reduction is 30 days after the event, but the reporting deadline for an active participant reduction due to attrition is extended to the due date for the payment of the plan sponsor's PBGC premiums (generally October 15 for calendar year pension plans)
A bankruptcy filing is no longer a reportable event
A loan default was expanded to require reporting where there is an amendment or waiver of any loan covenant for the purpose of avoiding a default
A merger of one controlled group member into another is no longer a reportable event

Conclusion

Although the final PBGC reportable event rules add many welcome exemptions for pension plan administrators, sponsors and contributing employers, these rules remain very fact specific and complex. In addition, failure to comply with the reportable event requirements also can result in significant penalty exposure, with a potential penalty of up to $1,100 per day for as long as the reporting delinquency continues. Given that a reportable event likely occurs sporadically rather than on a normal cycle, pension plan administrators, sponsors and contributing employers need to diligently monitor any changes in their pension plans and related controlled group entities to avoid reportable event errors and penalties.
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Moody's: Corporate plans could reach full funding in 2018 after interest rate increases

U.S. corporate pension plans could reach full funding in 2018 as a result of the Federal Reserve raising interest rates, said a report from Moody's Investors Service released Monday.

The aggregate funded status is estimated to remain at 78% at the end of 2015, unchanged from 2014 and only 200 basis points above the 2008 level of 76%. However, funding levels are expected to improve after interest rates rise, the report said.

If discount rates rise to either 5.7% or 6% by 2019, as anticipated, and the pension funds achieve their 7.75% annual assumed rate of return, the pension plans could achieve full funding in 2018, Moody's estimates.

If the pension funds achieve a 2% investment return for 2015, assets could reach $1.64 trillion at the end of year, down 1.8% from 2013 but up 54.72% from 2008, Moody's estimates in its report.

Liabilities are estimated to total about $2.09 trillion as of Dec. 31, down 1.88% from 2014, but up 50.4% from 2008, if the discount rate reaches 4.3%, at year-end. The average discount rate at the end of 2014 and 2008 was 4% and 6.5%, respectively.

The report also looked at plans' funding ratios if the discount rate increase is larger than expected, reaching 7.5% by 2019. Under that scenario, plans could achieve full funding in just 18 months, rising to more than 120% funded by the end of 2019. However, this wouldn't necessarily be a good thing, said Wesley Smyth, vice president, senior accounting analyst, at Moody's, and co-author of the report, in a telephone interview. If rates overshoot expectations and plans achieve 120% funding by the end of 2019, plan executives are going to be faced with trapped capital as they are prohibited from withdrawing funds until pension benefit obligations have been extinguished, Mr. Smyth said.

The defined benefit plans of roughly 670 rated U.S. non-financial companies were assessed.
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Risk Transfer Activity Significant; Over One Million People Affected

PBGC actuaries completed a study of risk transfer events (RTEs) in pension plans. Risk transfer, also known as "de-risking," is how companies eliminate their pension benefit obligations. In a risk transfer, a company either pays off participants with a lump sum or buys annuities from insurance companies to replace the company pension.

The study looked at patterns in the data on Form 5500s that pension plan sponsors filed with the government from 2009 - 2013. By using those patterns, the actuaries identified companies that had recent risk transfers.

PBGC is interested in these events because:
Lower insurance premium payments may affect PBGC's long-term financial condition.
Past risk transfer activity can help project future activity and help PBGC plan for its effects.
Participants may elect to receive lump sums. If so, policy makers will want to ensure they have the correct tools to manage their funds wisely.

The study looked at about 3,600 larger plans. Of those plans, over 500 had RTEs during the five year period. This is significant because more than one million participants left the plans as a result of the events. Almost 400 of the events involved lump sum payments; the remaining involved annuity purchases to replace the company pension.

Information regarding risk transfer activity has generally been limited to press reports of events conducted by major companies. The study is only an estimate of the level of risk activity since it concludes that a risk transfer has occurred indirectly by analyzing Form 5500 annual reports. PBGC has started collecting data from each pension plan detailing their risk transfer history to accurately determine patterns. We have begun receiving data, and expect to get this information annually from now on.

The study concludes that the plan sponsor's financial condition didn't determine risk transfer activity. Nor did union status. But while union plans and non-union plans were equally likely to offer risk transfers, the percentage of union members accepting them was lower.

Because the actuaries were cautious in declaring a pattern in the data, they think the actual number of risk transfers was probably higher than indicated by the study.
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Barry’s Pickings Online: DB/PBGC endgame

What happens when premium increases break the current system?

By this time, pointing out that increases in Pension Benefit Guaranty Corporation (PBGC) single employer plan premiums are driving sponsors out of the defined benefit (DB) system is commonplace.

There are, however, some nuances worth considering. And it’s probably time to begin thinking about what’s next—once these premium increases break the current system. In this column I want to discuss two things: the different effects of increases in the flat-rate premium and increases in the variable-rate premium; and possible PBGC endgames.

Department of Labor Employee Benefit Security Administration (EBSA) Assistant Secretary Phyllis Borzi has remarked that “There was never agreement when [the Employee Retirement Income Security Act] was passed and there isn't agreement now as to what PBGC was supposed to be.” Amen to that. To understand what is going on with the PBGC premium increases I think we need a clear answer to that question—what is the PBGC? In my view, the PBGC single employer system is (i) a tax, the PBGC flat- and variable-rate premiums, and (ii) a benefit, the PBGC guaranty of the sponsor’s pension promise.

From the sponsor's point of view, the question is, is the benefit worth the tax? And if it's not, what can the sponsor can do about it (e.g., reduce headcount, terminate the plan or fund unfunded benefits)?

From the PBGC's point of view, the question is, are the tax (i.e., premium) revenues worth the cost of the benefit (having to pay unfunded insured benefits on plan termination)? And if they are not, what can PBGC do about it (e.g., increase either the flat- or variable-rate premium or vary the premium based on the financial condition of the sponsor)?

Given these incentives, the increases in PBGC flat- and variable-rate premiums have different consequences. The flat-rate premium functions as a tax on headcount. So, ironically (at least for advocates of a broad-based DB system), the incentive for sponsors is to get rid of (cash out) participants with smaller benefits (because the flat-rate premium is a higher percentage of their benefits) and keep participants with larger benefits. More broadly, plans—like those for professional services employers—that benefit a limited number of mainly higher-paid participants (with larger benefits) can sustain the headcount tax. Plans with a lot of participants with more modest benefits will have a harder time doing so, and many of them will terminate—per the predictions of commentators.

All of that will reduce PBGC's premium revenue, but it will probably also reduce PBGC's exposure.

The variable-rate premium, on the other hand, is a tax on underfunding. That tax is at 3% for 2016 and is projected to go up to 4.7% by 2023. These increases provide a very strong incentive for sponsors to fund their benefits. We expect any company with a reasonable cost-of-borrowing to do just that. In one respect, that effect—an increase in funding—is benign and even desirable. For PBGC, the problem with this scenario is that over time the only companies left with underfunded plans will be those who don't have a reasonable cost-of-borrowing.

With respect to PBGC revenues, all of this is just a real life illustration of a version of the Laffer Curve: as you raise taxes (aka premiums), at some point revenues will start to go down, as taxpayers (in this case, DB plan sponsors) take action to avoid taxation.

As long as reductions in PBGC revenues are coupled with reductions in PBGC risk, this process is neutral (or conceivably even positive) with respect to the PBGC system.

It's not necessarily neutral, however, with respect to the DB system. With respect to ("hard") frozen DB plans—plans that no longer provide any accruals—the shift of these benefits to the private sector (via pension risk transfers) is, IMHO, a positive development. For sponsors, these are, for the most part, no longer "benefits"—they are just a legacy. Let the private sector handle it.

But to the extent that the increases in flat-rate premiums are driving out "live," broad-based DB plans, that's a problem. Somebody needs to take a hard look at that issue. I don't really see the

point of an "insurance" system that only insures plans for professional services corporations. And, btw, I'm pretty sure that the professional services corporation sponsors would agree. Especially since most of those plans are cash balance plans with, generally, a reduced risk of underfunding.

One thing we should all be thinking about: why a headcount premium? Given that PBGC's exposure is based on benefits up to a certain limit, shouldn't the flat-rate premium be based on the total insured benefits in a plan? I would also say that there should be a different premium for cash balance plans, given the fundamentally different risk presented by those plans.

The effect of the increases in the variable-rate premium is harder to fathom. The way I think of it, there is a line ("the margin"). On one side of that line are all the companies that can efficiently borrow-and-fund. On the other side are those that can't. Every increase in variable-rate premiums moves that line farther to the right.

The breakeven point—the point at which it's cheaper to borrow-and-fund—depends on a number of assumptions, critically the rate of return on plan assets. Assuming a 4% return and taking into account (as of each period) future increases and (where relevant) inflation, I estimate the breakeven point as follows:

Variable-rate premium rules in:

- 2012 (before MAP-21 increases), breakeven is 5.27%;
- 2012 (after MAP-21 increases), breakeven is 6.25%;
- 2013 (after year-end 2013 budget deal increases), breakeven is 7.91%; and
- 2015 (after October 2015 budget deal increases), breakeven is 9.21%.

The puzzle is, as the breakeven point has moved from 5.21% to 9.21%, what happens to the PBGC revenues versus risk equation? If all the sponsors left in the variable-rate "pool" are those whose borrowing cost (in these low-interest times) are above 9.21%, is that a good thing? Someone should be thinking hard about that.

In this context, it's understandable that PBGC would like to go to a "variable" variable-rate premium, with lower premiums for financially strong companies and higher premiums for financially weak ones. With these dramatic premium increases, that policy is being implemented in a crude way—all the financially strong companies will fund and only financially weak companies will remain.

The last of the multiplying ironies here is that Congress has demonstrated no concern with any of this. It has, since 2013 at least, simply sucked money out of PBGC premium payers as a phony solution to its budget problem.

Unless someone does something about all this, it's not going to end well.

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Senate passes church pension plan clarifications

Legislation to clear up tax and compliance issues for church pension funds was approved by the Senate by unanimous consent. A companion House bill has not advanced.

Sen. Ben Cardin, D-Md., who co-sponsored the bill along with Sen. Rob Portman, R-Ohio, said in a statement that the Church Plan Clarification Act of 2015 approved Dec. 10 brings more than 1 million clergy, faith institution workers and dependents "closer now to having the well-deserved peace of mind that comes with the financial security during retirement that we wish for every American." The bill corrects five legal and regulatory issues, including controlled group rules, grandfathered defined benefit plans, auto enrollment and transfers between plans.

Many church retirement plans are exempt from the Employee Retirement Income Security Act of 1974 and instead subject to state and federal laws and Church Alliance regulations, including state fiduciary standards, state contract law and tax rules.

Mr. Cardin said in a Senate floor statement Dec. 2 that the bill does not affect the definition of a church plan for tax or ERISA purposes. "In particular, no inference is intended by this legislation regarding the statutory requirements a pension plan must meet to be considered or treated as a church plan … and the bill has no bearing on the interpretation of those sections. Rather, the Church Plan Clarification Act is simply about fixing the rules that govern how church plans operate and serve their participants," Mr. Cardin said.

However, Pension Rights Center Director Karen Ferguson is worried that the legislation, if passed, could nonetheless have a negative effect on litigation filed by church plan participants. "We did not oppose the Senate bill because it only addresses highly technical tax concerns of certain church benefits boards and had nothing to do with the definition of church plans under ERISA and the Internal Revenue Code. We were pleased that in his floor statement Sen. Ben Cardin clarified that no inference about the definition of church plan was to be drawn from the Senate bill. We were shocked (then) that lawyers representing defendants in pending lawsuits would try to suggest that this bill could torpedo litigation completely unrelated to the bill," Ms. Ferguson said in an interview.

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