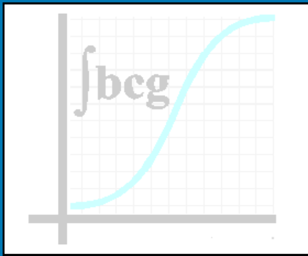

BCG Retirement News Roundup

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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

Secrecy in Pensions Triggers Legislative Brawl in North Carolina

A legislative fight between North Carolina Treasurer Janet Cowell and a state employee association is signaling growing tension over disclosure practices as public pensions seek to improve returns with alternative investments.

Cowell, a 45-year-old Democrat, opposed a bill by the State Employees Association of North Carolina to require more disclosure about deals with Wall Street firms hired to manage alternatives to stocks and bonds for the $87 billion pension she controls. Cowell warned that giving out more information would cost more than $1.8 billion for violating secrecy agreements, and instead supported a bill that would conceal details for five years after a contract is completed.

“Our pensions get huge amounts of money to invest from the employees,” said Representative Nathan Baskerville, a Henderson Democrat who co-sponsored legislation requiring immediate disclosure. “I need to be able to tell my constituents that we’re protecting their money. I need to know how much we’re paying.”

The dispute comes as states invest more in private equity and hedge funds in a bid to meet average return targets of 7.7 percent. Stocks and bonds no longer consistently deliver as the U.S. Federal Reserve holds benchmark rates near historic lows. When state can’t achieve their planned investment returns, they must increase funding out of their budgets or cut benefits.

Secrecy Agreements

Since 2001 states have increased allocations to alternatives to $460 billion, or 15.3 percent, from $66 billion, or 3.3 percent in 2001, according to the National Association of State Retirement Administrators.

Most private-equity and hedge-fund investments come with agreements that prevent pensions from disclosing certain information, including details on fees, investment strategy and other “trade secrets.”

Unlike fees for stocks and bonds, those for alternatives tend to be opaque, so the only way to get a complete picture of performance is by knowing how much the state is paying, Baskerville said.

Without that, taxpayers and employees have no way to know whether an investment is a good deal, said Andrew Biggs, resident scholar of the American Enterprise Institute, a Washington research group that studies politics, government and policy.

Inherent Opacity

“Alternatives are inherently less transparent,” Biggs said in an e-mail. “Hedge funds are understandably loath to discuss their trading strategies, since that’s what differentiates them from their competitors. But the public wants to know what investments are being made, what the risks are, and how much the pension is paying in fees.”

North Carolina assumes its pension must earn 7.25 percent annually to cover promised benefits and to calculate what local governments and the state must contribute. Some funds, such as the California Public Employees’ Retirement System, the biggest of its kind in the U.S. with almost $300 billion, have lowered return assumptions under pressure to reflect market realities.

North Carolina has about $18.7 billion of alternative investments, or 21.5 percent of its assets. In 2007 it was 3 percent and the state has authority to increase it to 35 percent. The pension lagged behind both of its benchmarks for private equity and hedge funds for the past 10 years, according to its financial report.

Still, the state paid $416.2 million to firms hired to manage pension money last fiscal year, according to its annual report. A footnote says that it didn’t disclose all fees, such as those for fund-of-fund investments.

Fee Inflation

Alternative investments have led to battles over disclosure in other states. Last month, the Pennsylvania Public School Employees’ Retirement System removed such contracts posted prior to 2012 from the treasurer’s website.

In May, U.S. Securities and Exchange Commission Chairwoman Mary Jo White told Congress that hedge funds and private-equity firms have created bogus service providers to boost fees from portfolio companies and investors. More than half of about 400 private-equity firms that the SEC staff examined charged unjustified expenses, Bloomberg reported in April, citing an unnamed person familiar with the findings.

Pension Sleuth

In January, North Carolina’s state employees association hired Edward Siedle, a former SEC attorney and now president of Benchmark Financial Services, to investigate the fund’s investments. Siedle found what he said are hundreds of millions of dollars of undisclosed fees. That led the association to push for legislation that would require information about alternative investments to be disclosed as soon as July.

In a legislature that has used its veto-proof Republican majority to pursue an agenda of tax and service cuts that set off weekly protests at the statehouse, the pension battle is striking for its bipartisanship.

Republicans are the majority of primary sponsors for both the bill backed by Cowell and the union-supported disclosure bill she opposes. Only the treasurer's bill is moving forward so far. Governor Pat McCrory, a Republican, doesn't comment on pending legislation, said Rick Martinez, a spokesman.

The five-year period of secrecy the treasurer supports would mean the statute of limitations for securities fraud claims would expire before documents are made public, said the employees association's general counsel, Tom Harris.

"This bill is bad," Ardis Watkins, a lobbyist for the association said at a committee hearing June 18. "It's going to enshrine bad practices. For a generation it's going to keep the public from knowing what they have a right know."

Sole Authority

North Carolina, New York, Connecticut and Michigan are the only states that have a single person overseeing their pensions, and Cowell has close ties with the financial services industry. She has taken campaign contributions from some companies that have won contracts to manage alternative investments.

Of the $1.1 million Cowell received for her 2012 campaign, $196,710 came from the financial industry, according to the National Institute on Monday in State Politics in Helena, Montana. People in New York City donated $133,300, more than came from Charlotte, North Carolina's biggest city.

Cowell's spokesman, Schorr Johnson, said the pension has grown 45 percent under Cowell and that she is committed to protecting its integrity.

"The performance of the pension fund is paramount," he said in an e-mail. "Transparency is strongly valued by the department of State Treasurer, and key to confidence in the investment process. Treasurer Cowell has implemented numerous ethics and disclosure reforms which make North Carolina's investment program one of the most transparent in the nation."

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The Not-So-Sunny Side of Pension Obligation Bonds

Some governments, particularly those with money problems, borrow to quickly pay down their pension obligations. But a new study shows it can leave them more financially vulnerable.

A tool that some governments have used to immediately pay down their pension obligations through borrowing can leave those governments more financially vulnerable than they were before, a new study says.

The tool, called Pension Obligation Bonds (commonly referred to as POBs), allows governments to issue taxable bonds for the purposes of putting money toward or fully paying off the unfunded portion of a pension liability. The proceeds from the bond issue go in the pension fund. The theory is that the rate of return on the investment will be greater than the interest rate the government pays to bond investors so that the transaction is favorable to the government; it makes money off the deal.

In actuality, however, a study issued in July by Boston College's Center for Retirement Research found that the stock market and interest rate swings have meant that many governments have paid dearly for issuing POBs, especially those that issued bonds in the mid-2000s or early 1990s. And, because financially distressed governments are more likely to issue the bonds, the results often mean even more financial problems.

The report noted that the governments more likely to issue POBs are ones that have pension plans that represent "substantial obligations." The governments have large outstanding debt and are short of cash. However, rather than necessarily relieving such governments of financial pressures, the bonds actually create a more rigid financial environment. Issuing bond debt to pay off a long-term obligation like a pension liability turns a somewhat flexible pension obligation into a hard and fast annual debt payment. Thus, "governments that have issued a POB have reduced their financial flexibility," the study says.

The governments of Illinois, California and New Jersey have been very active in issuing POBs over the last three decades, according to the report, which converted totals to 2013 dollars. Illinois and California have each issued more than $25 billion total, although more than $10 billion of Illinois' bonds have been issued after the stock market began rebounding in 2009. New Jersey has issued more than $11 billion in POBs since 1985. Yet the states still stand out as having some of the nation's highest unfunded liabilities. Illinois in particular has one of the country's worst funded ratios (less than 40 percent of its public employee pension system is funded). New Jersey and Illinois (and up until recently, California) have also continued to struggle with balancing their budgets, even after the recession ended in 2009.

POBs' net returns (what the investment has earns after making bond payments) has varied, depending on when the bonds were issued. According to the center's research, the net rate of return has averaged in the low, single digits for most years (the 30-year average is 1.5 percent). Governments that issued Pension Obligation Bonds in 1998, 1999, 2000 and 2007 actually lost money on their investment. Detroit, for example, issued debt at the peak of the market in the mid-2000s to fund its pension plan and did so using a complicated interest rate swap deal. The result was that the deal went the wrong way for the city. Detroit was still on the hook to pay bondholders and though its pension was well funded, it had even less day-to-day cash to meet its financial obligations. That debt played a key role in Detroit's decision to file for bankruptcy last July.

The authors said that POBs do have the potential to be used responsibly -- that is, "by fiscally sound governments who understand the risks involved or could play a role as part of a broader system reform package." For example, in 2002 and 2003, Sheboygan County and Winnebago County in Wisconsin borrowed more than $7 million combined and earned investment returns greater than 20 percent on the borrowed money. Meanwhile, they paid less than three percent interest on their debts so earned an extra 17 percent return as a reward for taking on additional risk. But, such examples such are few and far between.

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Bankruptcy judge may rule pensions can be cut

A federal judge handling the Stockton bankruptcy may be moving toward a landmark ruling that CalPERS pensions can be cut, possibly while allowing the city to exit bankruptcy in October without cutting its pensions.

U.S. Bankruptcy Judge Christopher Klein yesterday outlined an argument, a "summary from 50,000 feet," for treating CalPERS pensions like other debt, then invited CalPERS, Stockton and other parties to respond with written briefs.

The judge said he wanted to share his "preliminary thoughts" to give the lawyers in the case a chance to "straighten me out before I make some dramatic boneheaded mistake" about a simple understanding of the law.

Klein emphasized at the end of his remarks that his view of the "jigsaw puzzle" of how state pension law fits with federal bankruptcy law is still tentative. "I could be persuaded of opposite propositions," he said.

A federal judge ruled in the Detroit bankruptcy that public pensions can be cut in bankruptcy. But CalPERS has argued, among other things, that Detroit has a city-run plan and an "arm of the state" like CalPERS cannot be impaired in a federal bankruptcy.

Klein said the implication of his remarks is that he might conclude the CalPERS contract with Stockton is being rejected, and the $1.5 billion CalPERS would charge for terminating the contract is unenforceable.

"But that does not necessarily mean that this plan of adjustment (of debt to exit bankruptcy), which is proposed without any change to pensions, is necessarily not confirmable," he said.

Stockton does not want to cut pensions, arguing they are needed to be competitive in the job market, particularly for police. Stockton voters approved a ¾-cent sales tax increase last November to add more police and other public safety measures.

After filing for bankruptcy in June 2012, Stockton reached agreements with three bond insurers, all city unions and other major creditors. But in closed-door mediation the city could not reach an agreement with two Franklin bond funds, triggering a rare trial.

The city exit plan would pay Franklin $135,000 for a $36 million bond debt. Klein yesterday put a value of $4 million on the loan collateral the city said was of little value to Franklin due to use restrictions and other problems: two golf courses and a park.

A Franklin attorney told the judge $4 million in cash would be acceptable, but two other options mentioned by the city would be an issue: payment over time or giving Franklin the property.

The judge set a schedule for receiving briefs and responses before the next hearing Oct. 1. "Ideally, I would like to be able to make findings that conclude the matter," he said.

A decision to confirm the debt-cutting plan of adjustment, allowing Stockton to exit bankruptcy, would have to find that creditors are being treated fairly. The judge questioned whether the California Public Employees Retirement System is a creditor.

If a city pension plan is terminated and there is not enough money to cover obligations, Klein said, state law authorizes CalPERS to close the funding gap by cutting the pensions of workers and retirees.

"It seems to me if you are going to take away part of an individual's pension, the individual is the creditor and CalPERS is in effect a servicing agency," the judge said.

Klein mentioned that when ruling Stockton was eligible for bankruptcy, despite opposition from two big bond insurers who later settled, he found that workers took a "de facto haircut" through employment reduction and collective bargaining.

The judge also made an important ruling in 2012 that retiree health care can be cut in bankruptcy, allowing a debt valued at $544 million by Stockton to be replaced with a one-time payment of $5.1 million.

Klein may have been addressing the CalPERS "arm of the state" argument when he said the big system has "two different pieces" to the puzzle: state workers and cities and other local governments that contract for pension services.

The local governments voluntarily contract with CalPERS, he said, even though under state retirement law they can form their own retirement system or contract with county retirement systems or private providers.

"It looks like a city could bow out of CalPERS without necessarily being thrown out of CalPERS," he said, although that would be difficult.

Klein said he would like an explanation of two state laws that allow CalPERS to put a lien on the property of bankrupt cities and prevent bankrupt cities from rejecting their CalPERS contract.

He said a state law enacted in 1982 appears to be a response to a federal law in 1979, enacted in the wake of New York City's financial crisis, that allowed more than bond debt to be cut in a municipal bankruptcy.

"All of a sudden all sorts of debt potentially could be discharged," he said. "So it's no surprise … this lien is created."

Klein said the state lien law appears to conflict with federal bankruptcy in several ways. "As against that, it makes me wonder if this so-called lien is the kind of thing that could be enforced," he said.

The judge said exhibits filed during the trial show that a 1996 state law preventing bankrupt local governments from rejecting CalPERS contracts, prompted by the Orange County bankruptcy in 1994, was intended to protect CalPERS from losses.

Under his reading of state law, said Klein, the employees are at risk of losses in a bankruptcy, not CalPERS. "So I'm kind of wondering who was pulling the wool over the eyes of the California Assembly and state Senate," he said.

The judge said he would need a good explanation of what authority allows the California Legislature to revise the federal bankruptcy code. "My usual answer is none, unless specifically provided by the bankruptcy code," he said.

In addition to urging CalPERS to respond, the judge said a “helpful” city brief would show why the Stockton exit plan should be confirmed despite “what I have been hearing about CalPERS and the inviolability of the CalPERS contract and the lien.”

A CalPERS statement issued after the hearing yesterday said: “In fulfillment to our fiduciary duty, CalPERS will continue to protect the benefits promised to our members.

“We welcome the opportunity to respond to the questions Judge Klein raised in court today, to discuss the implications of the California laws that govern pensions and that create a stable retirement system that provides significant value to cities and their employees.”

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Detroit Retirees Back Pension Cuts by a Landslide

A year after filing for bankruptcy, Detroit is building momentum to get out, especially after workers and retirees voted in favor of major pension changes just a few weeks before a judge holds a crucial trial that could end the largest public filing in U.S. history.

Pension cuts were approved in a landslide, according to results filed shortly before midnight Monday. The tally from 60 days of voting gives the city a boost as Judge Steven Rhodes determines whether Detroit's overall strategy to eliminate or reduce $18 billion in long-term debt is fair and feasible to all creditors. Trial starts Aug. 14.

"I want to thank city retirees and active employees who voted for casting aside the rhetoric and making an informed, positive decision about their future and the future of the city," said Kevyn Orr, the state-appointed emergency manager who has been handling Detroit's finances since March 2013.

General retirees would get a 4.5 percent pension cut and lose annual inflation adjustments. They accepted the changes with 73 percent of ballots in favor. Retired police officers and firefighters would lose only a portion of their annual cost-of-living raise. Eighty-two percent in that class voted "yes."

Voting ended July 11, and the counting was done by a private company.

Support for the pension changes triggers an extraordinary $816 million bailout from the state of Michigan, foundations and the Detroit Institute of Arts. The money would prevent the sale of city-owned art and avoid deeper pension cuts. The judge, however, still must agree.

In a statement Tuesday, Michigan Gov. Rick Snyder said the vote is recognition that the state has pulled together in support of the city. He noted that many people faced "difficult decisions" and said their sacrifices are appreciated.

"We have farther to go down this road," Snyder said. "But the vote tallies show how far we've come in the past year, and that Detroit's future is increasingly brighter."

Anthony Sabino, a bankruptcy expert who teaches business law at St. John's University in New York, said results of the voting are a big win for the city.

"It will pave the way for a confirmation hearing. Detroit will be able to move forward, not with absolute financial certainty but far more than Detroit has enjoyed in decades," he said.

Indeed, a Boston-based restructuring expert hired to advise the judge said Monday Detroit's overall bankruptcy plan is "feasible," a key standard at the upcoming trial. But Marti Kopacz warned that antiquated computer systems, a pledge to spend more than $1 billion to improve services after bankruptcy and a "cultural malady" among workers all will be challenges.

"There are ... employees who don't grasp that their job is to provide a service to the taxpayers versus the taxpayers owing them a job," Kopacz said in a report released Monday.

There are tens of thousands of creditors in Detroit's bankruptcy, from bond holders to businesses that provide soap, but much of the focus of the last year has been on the roughly 32,000 retirees and current and former workers banking on a pension. They have put a real and often anguished face on the process.

The judge set aside a day last week to hear the personal stories of retirees frightened about getting smaller checks.

The average annual pension for police and fire retirees is $32,000, while most other retired city workers get $19,000 to $20,000. Orr has said pension changes are unfortunate but necessary because two funds are underfunded by billions. If investment performance improves in the years ahead, he said, the cuts could be restored.

Many retiree organizations had urged a "yes" vote, insisting the pension changes were the best option under tough circumstances. But Dorothy Baker, 64, disagreed. Besides the pension cut, the library retiree who lives in suburban St. Clair Shores would lose a portion of her annuity earnings.

"Don't they sell assets in bankruptcy? They haven't sold any assets. There are parking garages and golf courses," said Baker, who worked for Detroit for nearly 39 years.

The Michigan Constitution says public pensions can't be cut, but Rhodes said in December that federal bankruptcy law trumps that shield. It was a groundbreaking opinion that could influence local governments across the country that go broke.

Michigan Attorney General Bill Schuette believes the judge is wrong, but he won't appeal now that retirees have voted for the cuts.

"I will respect their decision," Schuette said in a statement.

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Public pension plans reap benefits from Citigroup settlement

State pension funds in California and Illinois are among the recipients of Citigroup Inc.'s $7 billion in fines and consumer relief to resolve government claims that it misled investors about the quality of mortgage-backed bonds sold before the financial crisis.

The accord includes a record $4 billion civil penalty to the Justice Department, $500 million to state attorneys general and the Federal Deposit Insurance Corp., and about $2.5 billion in various forms of consumer relief to be provided by the end of 2018, the bank said in a statement July 14.

California Attorney General Kamala D. Harris announced in a statement that the state will receive $102.7 million in damages, which will reimburse the $300.9 billion California Public Employees' Retirement System, Sacramento, and the $189.1 billion California State Teachers' Retirement System, West Sacramento. The state also will receive $90 million in consumer relief.

Illinois Attorney General Lisa Madigan said in a statement that Illinois is receiving $44 million to reimburse the $44.2 billion Illinois Teachers Retirement System, Springfield; the $16.9 billion Illinois State Universities Retirement System, Champaign; and the $14.8 billion Illinois State Board of Investment, Chicago, which oversees the State Employees' Retirement System, General Assembly Retirement System and Judges' Retirement System. The state is also receiving $40 million in consumer relief.

New York is receiving $92 million in cash and $90 million in consumer relief, said state Attorney General Eric Schneiderman in a statement, but he did not specify how much would specifically go to the state's pension funds.

Citibank took a $3.7 billion charge in the quarter ended June 30 to cover the cost of the settlement, the firm said in its statement.

Citigroup was among lenders investigated by the Justice Department for allegedly misrepresenting the quality of mortgage-backed bonds sold to investors before 2008's credit crisis. J.P. Morgan Chase & Co., the biggest U.S. bank, agreed in November to pay $13 billion to resolve similar federal and state probes. The government has sought about $17 billion from Bank of America, a person familiar with those talks has said.

“The bank's misconduct was egregious,” U.S. Attorney General Eric Holder said in a text of his prepared remarks. “And under the terms of this settlement, the bank has admitted to its misdeeds in great detail.”

The settlement, which caps months of negotiations, covers securities issued, structured and underwritten between 2003 and 2008, according to Citigroup.

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Private Sector

Insurer Warns Some Pooled Pensions Are Beyond Recovery

More than a million people risk losing their federally insured pensions in just a few years despite recent stock market gains and a strengthening economy, a new government study said on Monday.

The people at risk have earned pensions in multiemployer plans, in which many companies band together with a union to provide benefits under collective bargaining. Such pensions were long considered exceptionally safe, but the Pension Benefit Guaranty Corporation reported in its study that some plans are now in their death throes and cannot recover.

Bailing out those plans seems highly unlikely. But if they are simply left to die, the collapse of the federal insurance program is all but inevitable, the report said, leaving retirees in failed plans with nothing. It added that the program “is more likely than not to run out of money within the next eight years” as plan after plan collapses.

The multiemployer pension sector, which covers 10 million Americans, represents a mixed bag of financial strength and weakness. The aging of the work force, the decline of unions, deregulation and two big stock crashes have all taken a grievous toll. Ten percent of the people covered are in severely underfunded plans, the study said.

The federal insurer is not making any recommendations about what to do at the moment, said Joshua Gotbaum, its director. “This is a legally required actuarial report whose purpose is solely to project the range of outcomes for plans and the P.B.G.C.”

The agency does such a projection every year, but this year’s version was unusually late and unusually dire.

Congress has already held several hearings on multiemployer plans, and for months the unions and companies that jointly sponsor them have been meeting with Congressional staff members to come up with responses. One working proposal calls for retirees in multiemployer plans to give up part of their core benefits to save money. That idea is extremely controversial because federal law has sheltered retirees from such cuts for decades. Proponents say it is the only way to keep some plans going.

Even if the new report spurs them, no legislative initiative is expected until after November’s elections.

The report’s dire prognosis was limited to the multiemployer pension insurance program. The federal insurer has a separate program for the pensions offered by single companies, and the report said it was not at risk. In fact, its finances have improved over the last year, the report said.

The multiemployer insurance program works differently from the single-employer one, and the report expressed concern that the people at greatest risk were unaware of how deeply their pensions could be cut if the situation deteriorated. The maximum insurance benefit is less than $13,000 a year, and that is only for people who have at least 30 years of service. In some plans, notably the Teamsters’ troubled Central States plan, many workers and retirees have already earned pensions well above the insurance maximum.

Congress never gave the program a lot of resources, paradoxically, because in the past the plans were considered so healthy that they did not need as much insurance protection. Employers pay much smaller premiums and the insurance coverage is much more limited than for single-employer pensions. And the P.B.G.C. itself has no power to step in and rescue a dying plan, the way it can if a single-employer plan is at risk of failing. It can only sit on the sidelines and get its meager checkbook ready.

The strength of multiemployer pensions grew out of the fact that they pooled the resources of many companies. If one company in the pool went bankrupt, the others were required to pick up the cost of the resulting “orphaned” retirees. In the past, new unionized companies would join the pools over the years, keeping them strong.

Those factors began to change as the work force aged, unions dwindled and whole sectors of the economy were deregulated. And then came the dot-com crash of 2000, which pummeled many pension investment pools.

In 2006, Congress passed a law intended to strengthen company pensions, and the new study looked, for the first time, at how employers were responding to it. Adding this behavioral information required a major change in the pension organization's methodology, which Mr. Gotbaum said was among the main reasons the report came out months late.

The 2006 law required severely troubled multiemployer plans to set up rehabilitation programs and file the details with the government. In general, companies were supposed to put more money into their shared investment pools, workers were supposed to build their benefits more slowly, and retirees were supposed to give up the parts of their pensions that were not considered core benefits.

But when the researchers began started tracking employer behavior, they found that a significant number of multiemployer plans were so hard hit that their trustees decided not to use all the medicine prescribed in 2006. They did not think it would do any good and might even make things worse.

Mr. Gotbaum said the agency realized this over the last year or two, because more and more plan officials had been notifying the government that they were not in compliance with their own rehabilitation plans.

“They told us, ‘It's not that we're not willing to do it,’ ” he said. Rather, the plan trustees told the government that they had run into limits in how far they could push their companies and workers without destroying their whole pension plans.

Much of the problem was demographic. The most troubled plans often had more retirees than active workers. Trustees of those plans realized that they were pushing the workers to tighten their own belts in order to let the retirees keep receiving bigger benefits than the workers thought they would ever get themselves. If they kept pushing, the workers or the sponsoring companies would drop out of the pool, setting up a slow but steady death spiral.

“There is a concern that if the severely distressed plans fail, that this might lead to efforts to abandon healthy plans, too,” Mr. Gotbaum said.

Both federal insurance programs were designed to be self-supporting, and while the pension agency has operated for years at a deficit, it has not needed to turn to the taxpayers for assistance. Giving it the means to rescue failing multiemployer pension plans now would almost certainly require an act of Congress to put more money into the agency's coffers.

Given the political climate in Washington, Congress would not likely support such a bill without first seeing that workers, retirees and unionized companies had already made serious sacrifices.

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Corporate pension plan funded status flat for quarter, up in June — 3 reports

The funded status of a typical U.S. corporate defined benefit pension plan remained relatively unchanged at slightly less than 90% in the second quarter, said Legal & General Investment Management America's quarterly Pension Fiscal Fitness Monitor.

BNY Mellon Investment Management and Wilshire Consulting also both reported slight increases in the funded status of typical corporate DB plans in June.

Strong equity market returns offset falling interest rates, resulting in unchanged funded status levels, said Donald Andrews, head of LDI strategy at LGIMA, in a phone interview.

Global equity rose 5.2% in the second quarter, and discount rates fell 23 basis points, causing liabilities to increase by about 4%, Mr. Andrews said.

Mr. Andrews added that volatility remains low and plan executives continued to show interest in implementing option-based strategies.

LGIMA's fitness monitor assumes an investment strategy of 60% global equity and 40% aggregate fixed income.

Separately, the typical corporate DB plan rose to 92% in June, up 1.4 percentage points from the previous month due to strong asset returns and falling liabilities, said the BNY Mellon Institutional Scorecard. Liabilities fell 0.2% in June, while assets returned 1.4%.

Meanwhile, the typical public DB plan returned 1.6% for a second consecutive month, exceeding its monthly return target of 0.6%.

The typical foundation and endowment returned 1.7%.

Despite the funding increase, the typical corporate DB plan is still down a total of 3.2 percentage points from a high of 95.2% at the end of December, BNY Mellon said.

Separately, the funded status for the typical U.S. corporate pension plan rose one percentage point in June to 87.1% due to strong equity returns, said a monthly report from Wilshire Consulting.

Since Jan. 1, the funding ratio has decreased 2.7 percentage points from 89.8%.

The typical pension fund, as studied by Wilshire, has an asset allocation of 33% domestic equity, 26% long-duration fixed income, 22% international equity, 17% core

fixed income and 2% real estate. Wilshire uses data of S&P 500 company pension funds derived from corporate filings to create the model plan.

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LONG-TERM DOWNWARD TREND OF FEES PAID BY 401(K) INVESTORS IN MUTUAL FUNDS CONTINUED IN 2013

The following information was released by the Investment Company Institute:
Participants in 401(k) plans incurred lower expenses investing in long-term mutual funds (equity, hybrid, and bond funds) in 2013 than in 2012, the Investment Company Institute (ICI) found in an annual research report released today. The decline in these expenses is consistent with the downward trend of the past decade.

The report, "The Economics of Providing 401(k) Plans: Services, Fees, and Expenses, 2013," shows that plan participants holding mutual funds tend to invest in lower-cost funds. At year-end 2013, nearly 38 percent of 401(k) plan assets were invested in equity mutual funds. In 2013, 401(k) plan participants who invested in equity mutual funds paid an average expense ratio of 0.58 percent, down from 0.63 percent in 2012. Similarly, expense ratios that 401(k) plan participants paid for investing in hybrid mutual funds fell from 0.60 percent in 2012 to 0.58 percent in 2013. The average expense ratio 401(k) plan participants incurred for investing in bond mutual funds dropped from 0.50 percent in 2012 to 0.48 percent in 2013.

Participants in 401(k) Plans Tend to Pay Lower Fees for Mutual Funds

Participants in 401(k) plans tend to pay lower fees than fund investors overall. The 0.58 percent paid by 401(k) investors in equity funds is lower than the expenses paid by all equity fund investors (0.74 percent) and less than half the simple average expense ratio on equity funds offered for sale in the United States (1.37 percent) (see the figure below for more detail). The experience of hybrid and bond fund investors is similar.

"It is clear from this study that 401(k) participants investing in mutual funds tend to invest in lower-cost funds," said Sean Collins, senior director of industry and financial analysis. "This tendency on the part of investors sets up a competitive dynamic within the fund industry, as funds strive to provide ever better services at even more competitive prices. This dynamic is amplified to the benefit of retirement savers through the design of the 401(k) system, in which plan sponsors as fiduciaries select mutual funds as investment options for their plan."

401(k) Mutual Fund Investors Tend to Pay Lower-Than-Average Expenses

1. The industry average expense ratio is measured as an asset-weighted average.
2. The 401(k) average expense ratio is measured as a 401(k) asset-weighted average.

Note: Data exclude mutual funds available as investment choices in variable annuities.

Sources: Investment Company Institute and Lipper

Cost of Mutual Fund Investing in 401(k) Plans Has Declined Substantially Since 2000

For more than a decade, the costs 401(k) plan participants have incurred for investing in long-term mutual funds have trended down, according to the study. For example, in 2000, 401(k) plan participants incurred expenses of 0.77 percent of the 401(k) assets they held in equity funds. By 2013, that had fallen to 0.58 percent, a 25 percent decline. The expenses 401(k) plan participants incurred for investing in hybrid and bond funds also fell from 2000 to 2013, by 19 percent and 21 percent, respectively.

Regulatory Requirements Impose Costs on Operating a 401(k) Plan

The report also explains that 401(k) plans are a complex employee benefit, largely due to regulatory and other costs of offering a 401(k) plan. Employers offering 401(k) plans are fiduciaries to the participants. They typically hire service providers to operate these plans and must ensure that the costs for plan services are reasonable. Employers and employees generally share the costs of operating 401(k) plans.

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Pension smoothing part of Highway Trust Fund deal

The House Ways and Means Committee late Tuesday proposed pension smoothing as part of a funding package for the Highway Trust Fund, which is projected to run out of money within weeks.

Chairman Dave Camp, R-Mich., said in a statement that the package, while not perfect, is “viable … and should pass both the House and Senate quickly.”

H.R. 5021 is expected to win committee approval Thursday. The Senate Finance Committee is still working on its own proposal, but Mr. Camp said the House version “is the only package with a proven history of getting big bipartisan votes in both the House and Senate.”

Building on a similar feature of the MAP-21 highway bill passed in 2012, the committee proposal would allow corporations a range of rates for calculating defined benefit plan liabilities, which determine contributions to the plans. The most generous funding calculation, which ended with 2012 plan years, would now be available to sponsors through 2017. The reduced pension funding contributions resulting from the change would bring in an estimated total of $6.4 billion in tax revenue, according to a Joint Committee on Taxation estimate of the committee's proposal.

Groups representing corporations also welcomed the absence of further premium increases for the Pension Benefit Guaranty Corp., which had been considered in earlier proposals. “We are very supportive of the approach that the Ways and Means committee and Chairman Camp has taken,” said Kathryn Ricard, senior vice president for retirement policy at the ERISA Industry Committee, in an interview. “Funding pension plans is a long-term effort, and we are always happy to have the support of members of Congress who view this as a long-term liability and therefore a long-term funding obligation.”

“It's something that we think a lot of companies will benefit from,” said Lynn Dudley, senior vice president of global retirement and compensation policy for the American Benefits Council. “We've always believed in funding stabilization, especially when interest rates are very low, because it allows companies and plans to stay stronger.”

According to a Society of Actuaries analysis, MAP-21 pension funding changes benefited well-funded plans as well as those that were less funded in 2012. The SOA found that plans using MAP-21 to set funding levels were more likely to have larger numbers of participants or a higher proportion of inactive participants.

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Thousands of 401(k)s Fail Nondiscrimination Tests

Thousands of 401(k) plans failed their recent IRS nondiscrimination testing and had to return excess contributions to highly compensated employees because of imbalanced retirement plan coverage, according to research by a 401(k) advisory firm.

Almost 60,000, or about 12 percent, of plans reviewed were forced to make “corrective distributions” to HCEs in 2012, the latest available data from the U.S. Department of Labor, Judy Diamond Associates’ research concluded. The paybacks, which can be taxed as regular income by the federal government, totaled $794 million, the plan adviser said. The portion of plans with corrective distributions in 2012 was down 2 percentage points from the previous year.

Nondiscrimination testing may be the administrative bane of every retirement plan sponsor, yet passing a nondiscrimination test is necessary to obtain the tax advantages associated with being a qualified plan.

Different Kinds of Tests

Nondiscrimination tests involve dividing a workforce into groups of high-paid employees and low-paid employees. This process varies with the type of benefit being tested. Some tests focus on HCEs, while others focus on “key employees,” “highly compensated individuals” or “control employees.” Some of the tests require leased employees to be counted as employees for testing purposes; others do not. And finally, the rules are not uniform, nor do they provide clear guidance on how the tests should be applied to former employees, employees of related corporations or individuals who are employed in separate lines of business, according to Thompson Information Services’ The 401(k) Handbook.

Specifically, to obtain the tax advantages associated with being a qualified plan, a 401(k) plan must cover a nondiscriminatory group of employees under the provisions of Code Section 410(b). In addition, contributions or benefits under the plan may not discriminate in favor of highly compensated employees under the provisions of Code Section 401(a)(4). In general, these requirements mean that a qualified plan may not provide higher-paid employees with a “better deal” than the plan provides rank-and-file employees.

Having to make corrective distributions can indicate that “a plan is not designed to encourage workers to contribute sufficiently,” Eric Ryles, managing director of Judy Diamond Associates, said.

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