



# 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

### A Pension Fund Invests Against the Rules, and Wins

Are the trustees of the Tampa firefighters and police officers pension fund out of their minds?

“Quite a few people tell me we’re crazy,” Richard Griner, a 41-year-old Tampa police detective and vice chairman of the pension fund’s board, told me this week. “I go to quite a few investment conferences. They just can’t believe that we do this the way we do. But then I tell them the numbers, and they tend to shut up.”

The Tampa, Fla., pension fund may be unique in its approach to managing its assets, which totaled \$1.76 billion as of last September. Unlike the so-called Yale model, which has been widely copied and stresses alternative investments, the Tampa fund has no hedge fund or private equity investments.

But neither does it follow the low-cost, index-oriented approach championed by Vanguard and others. The Tampa fund doesn’t own index or mutual funds.

As for being diversified, which is the mantra of nearly all institutional money managers and consultants, it isn’t. A single outside manager makes all investment decisions, and the fund’s assets are concentrated in a relatively small number of stocks and fixed-income investments.

In short, the Tampa pension fund pretty much breaks all the conventional rules of fund management.

But then there are the numbers, as Mr. Griner put it.

Over the last 20 years, the Tampa fund has generated an average annualized return of 9.88 percent as of last Sept. 30, which puts it in the top 1 percent of public pension plans with assets of more than \$1 billion, according to the Wilshire Trust Universe Comparison Service from the investment advisory firm Wilshire Associates. The fund’s 10-year annualized return (9.72 percent) and 25-year return (10.48 percent) also rank in the top percentile.

By comparison, a conventional 60/40 mix of investments — 60 percent in a Standard & Poor’s 500-stock index fund and 40 percent in a bond index fund — generated a 20-year average annualized return of 7.9 percent, and the S.&P. 500 generated 8.8 percent. Calpers, the giant California pension fund whose highly diversified approach has been widely copied among pension funds, generated 7.7 percent over the same period.

Yale University remains the champion, with a 13.5 percent average return over a 20-year period. But over longer periods, the Tampa fund is coming close. Since Bowen, Hanes & Company started managing the fund in 1974, it has generated an average annualized return of 12.2 percent, and its assets have grown to over \$1.75 billion from \$12.1 million.

Thanks to the fund's performance, Tampa's retired police and firefighters enjoy retirement benefits that are the envy of many state and local governments. After 30 years of service, retirees are paid a pension that amounts to 94.5 percent of their average compensation for the highest three years of their last 10 years on the job. On average, that amounts to just over \$40,000 a year for nondisabled retirees. The fund has 3,326 beneficiaries.

The man responsible for these numbers since the late 1990s is Harold J. Bowen III, known as Jay, president of Bowen, Hanes, based in Atlanta. Bowen, Hanes has been managing the fund for 40 years, which may be a record for longevity. I was curious to meet Mr. Bowen when he was in New York recently, since consistently beating the S.&P. 500 over 10 or 20 years, let alone 40, is all but unheard-of.

Mr. Bowen, 52, is tall and thin — he will be competing in the Escape from Alcatraz triathlon in San Francisco on June 1 — and his investment approach, based on his description, could be considered boring. An English major at the University of North Carolina, he got interested in economics and attended the London School of Economics before joining his father's firm in 1986. His father, Harold J. Bowen Jr., forged the tie to the Tampa fund and generated its high returns before handing his investment philosophy and clients to his son.

"We take a very plain-vanilla approach," Mr. Bowen said. "No private equity, no hedge funds, no speculative bonds."

The fund maintains a conservative asset allocation of 65 percent equities and 35 percent fixed income. Before 1980, the fund owned no foreign securities; today, those securities can go to 25 percent. But it has no emerging market equities. "We're risk-averse and very quality oriented," Mr. Bowen said. "We don't want to speculate. We're not trying to hit the ball out of the park."

His firm charges low fees: For the Tampa fund, it's a flat 25 basis points of assets under management, or \$4.4 million last year based on the fund's value as of Sept. 30. By comparison, Calpers spent \$33 million in 2012 just on consultants, which doesn't include any management or performance fees

But Mr. Bowen's approach isn't passive. The key to the fund's strong performance has been old-fashioned stock picking, and a relatively concentrated portfolio of 70 to 80 stocks. "We're looking for the blue chip companies of the future," Mr. Bowen said, which tend to be companies with market capitalizations of \$500 million to several billion.

He also takes a value approach, looking for companies that are out of favor and seem undervalued by the market. Then, the fund holds its positions over long periods. Mr. Bowen oversees five investment professionals, and they take a “thematic, top-down approach,” identifying macroeconomic trends and stocks that will benefit.

Currently, the fund has a focus on global, consumer-oriented companies like Unilever and Nestlé. Over the last decade or so, the firm was astute at identifying the commodities boom and moved into Canadian resource companies like the nickel producer Inco (which generated a big gain when it was taken over by the Brazilian mining giant Vale). After the financial crisis, the fund shifted away from natural resources, although it still holds some positions.

Mr. Bowen expresses some surprise that his concentrated, buy-and-hold, value-oriented approach is considered so unorthodox among pension fund managers. “It’s pretty much what Warren Buffett does,” he said. “He’s not diversified, either. But practically no one else follows his model. We’re like salmon swimming upstream. The consultants have been trying to wedge their way in here, but after 40 years, the trustees back me.”

Mr. Griner, the pension board vice chairman, said: “Every time I go to a conference, there’s a sales pitch that, the more you diversify the safer you are. But my train of thought is: I’ve got a 40-year return rate here that blows any methodology out of the water. No one else, not the big money managers, not the big endowments, have the same returns with such low fees. We’ve got a history of 20-year rolling returns that’s higher than what the S.&P. is putting out. That’s as solid as you can get. As long as Jay keeps producing those kinds of returns, I can’t fathom changing anything.”

Both Mr. Bowen and Mr. Griner acknowledge that the fund doesn’t always outperform broader averages. Last year, the fund’s return of 15.11 percent qualified for the 14th percentile in the Wilshire Universe, and trailed the S.&P.’s 19.3 percent return over the same period. (The fund’s stocks, however, did outperform the S.&P. 500.) “We have the luxury of taking a long-term approach, Mr. Bowen said. “If we outperformed the S.&P. 500 every year, we’d be doing something wrong.”

Mr. Griner said that a patient, long-term approach is instilled in new trustees by others on the board. (He’s one of nine trustees, which include three each from the fire and police departments and three appointed by the mayor.) “Our fund exists in perpetuity,” he said. “So a three- or one-year outlook, it has some influence, but it’s not going to dictate our outlook. We want growth over 50, 60 years. We want Jay to look long term and give us stable long-term results.”

Michael Schlachter, a managing director at Wilshire Associates, is one of the skeptics about the fund’s approach and its ability to keep generating such high returns. He said that handing all of a pension fund’s assets to a single manager like Mr. Bowen “is

extremely unusual and it poses a fair amount of risk. To assume that one firm is the best in every asset category, especially a small firm that no one around here has ever heard of, is extremely risky. What if a bus hits the senior person?"

Mr. Griner said he understood why others were skeptical. "The only real down side to having a single manager is if you have a bad one," he said. "You think of all the managers. How many can outperform the S.&P. over any period of time? It's very hard to find anyone with any consistency over a decade who can outperform the S.&P. It's unheard-of. We happened to have gotten a good one, and he's done a phenomenal job. But I don't fault others. It would be scary to entrust everything with one person and hope you've gotten the right person." He added, "I hope it never happens, but if Jay leaves, a low-fee index option might be the way to go."

Mr. Griner and his fellow trustees serve on the board without pay, but he credits the experience with changing his life. "I'd dabbled in the stock market," he said, but since joining the board, "I've been to seminars. I've taken classes at Wharton. This summer I'm going to Harvard." He's taking classes at the University of South Florida and is studying to become a certified financial planner.

"We let Jay make the decisions, but I like to know how, why and when," Mr. Griner said. "I yearn for that knowledge."

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## GASB Declines to Delay Implementation Date of Pension Standards

The Governmental Accounting Standards Board today voted unanimously not to delay the implementation date of GASB Statement No. 68, Accounting and Financial Reporting for Pensions. The requirements of Statement 68 are effective for periods beginning after June 15, 2014.

The request to the Board for an indefinite delay in implementation date came from stakeholder groups that asserted that such a delay is necessary until related auditing procedures have been implemented for a sufficient period. The concern was expressed that governments in multiple-employer pension plans will receive a modified audit opinion on their financial statements in the interim.

Other individuals, organizations, and stakeholder groups wrote to the Board requesting that the implementation date of Statement 68 not be changed. Some of these groups

urged the GASB and other organizations to find a solution that does not involve a delay in implementation.

“The Board agreed that the issues raised by its stakeholders warranted thoughtful consideration. In response, we undertook a significant effort to gather meaningful input as quickly as possible in order to address these concerns on a timely basis,” said GASB Chairman David A. Vaudt.

“The GASB is committed to doing everything it can to assist governments, pension plans, and their auditors with the implementation of Statement 68, including working with stakeholder groups,” said Mr. Vaudt. “However, the Board does not believe that delaying implementation will benefit its stakeholders in general.”

The Board’s decision was based on feedback received from its stakeholders, including officials from governments and pension plans, auditors, actuaries, and users of financial statements. Key factors considered included:

- Delaying the new standards would not necessarily address the concern about a modified audit opinion. It appears, based on feedback received, that many governments would face a similar prospect of a modified audit opinion even if governments were to follow the previous pension standards.
- Pension plans are already well into the process of implementing the associated pronouncement, Statement No. 67, Financial Reporting for Pension Plans. If the implementation of Statement 68 were postponed, some governments would now incur the added cost of engaging an actuary to provide information under the old standards in addition to the information already obtained under the new standards.
- The financial statement users who provided feedback to the GASB expressed a strong preference not to delay Statement 68. These users understand the circumstances under which some governments may receive modified audit opinions. They stated that a clearly worded modification would not negatively impact their analyses of government finances.
- Concerns about the effort required to implement Statement 68, particularly with regard to governments in some cost-sharing multiple-employer pension plans, are real and significant. However, the Board was fully aware of these issues when it originally considered the costs and benefits associated with establishing the original implementation date. No new evidence has been brought forth to date that would result in the reconsideration of this conclusion.

## Gov. Christie Retroactively Cuts State Pension Payment

Facing another year of fiscal problems, Gov. Chris Christie changed the funding formula for the state's pension contribution so that he could cancel \$93.7 million in previously budgeted pension payments due in June, cut next year's pension bill by \$150 million, and put \$900 million less into the underfunded pension system by the end of his term.

Christie's decision to change the pension calculation formula will further add to New Jersey's \$51 billion unfunded pension liability -- which was one of the main reasons Fitch's Ratings cited last Friday when it followed Moody's and Standard & Poor's in downgrading the state's credit outlook from "stable" to "negative." Over a 30-year period, Christie's formula change would swell the state's unfunded pension liability by 10 percent, actuaries for the state's pension funds reported.

Christie complained during his annual Budget Message on February 25 that the rising costs of pensions, retiree health benefits, and debt service were crowding out other budget priorities. The governor threatened to take unilateral action unless the Democratic-controlled Legislature took further steps to reduce the state's retiree liabilities, presumably by requiring public employees to pay more toward their pensions.

What Christie didn't tell the Legislature or the public that day was that his Treasury Department had already instructed the actuaries responsible for calculating the state's required pension payment to change the formula not only to cut the state's pension payment for the upcoming year, but to do so retroactively for the current year.

Christie's decision to change the pension calculation formulas came as a surprise to Democratic legislative analysts, who wondered why Christie was putting only \$2.25 billion -- instead of the expected \$2.4 billion into the pension system in the Fiscal Year 2015 budget. The change in the funding formula was buried in the actuarial reports on the state's pension systems that were issued on February 27 -- two days after Christie's speech.

### Retroactive Cuts

But it wasn't until Treasurer Andrew Sidamon-Eristoff provided a list last week of the \$694 million in current-year spending cuts used to plug the hole in this year's budget that the nonpartisan Office of Legislative Services and Democratic experts knew for sure that Christie was retroactively cutting the size of the pension payment that had been approved in the Fiscal Year 2014 budget he had signed into law last June.

Ironically, the current-year pension cuts were listed on Sidamon-Eristoff's spreadsheet as a \$62.823 million "Teachers' Pension and Annuity Fund Surplus," a \$29.349 million "State and Higher Education Pension Surplus," and a \$1.569 million "Local Employee Pension Surplus" -- even though New Jersey's unfunded pension liability is \$51 billion



and growing because the state is contributing just 43 percent of its true actuarial obligation to the pension system this year.

If Christie did not change the formula, he would have had to find another \$93.7 million in cuts to balance this year's budget and \$150 million in reductions in next year's budget. That would have required cuts to existing programs because pensions, retiree health benefits, and debt service are already eating up 94 percent of the increase in state spending, as Christie pointed out in his budget speech.

Kevin Roberts, Christie's press spokesman, said in response to an emailed question Sunday that pension "assumptions are set by the actuaries not by the administration," and that "the state's payment is 4/7 of what is recommended by the actuaries. So your entire premise is flawed to begin with." Roberts and Treasury Department spokesman Christopher Santarelli failed to respond to detailed followup questions on Monday.

After this article appeared, Roberts pointed out that the Christie administration does not have the unilateral authority to make changes in the pension calculation methodology, and that the changes in methodology in the actuarial reports went to the employer-employee governing boards for the various pension funds for approval.

However, those meetings took place in early March -- after the governor had already included the cuts in the pension contribution both in his budget for FY2015 and in the list of \$694 million in budget-balancing cuts for FY2014.

PBA President Anthony Wieners complained vociferously that the changes in pension methodology, which also enabled local governments to lower their pension contributions by a total of \$135 million, would further weaken a pension system that Christie had already categorized as "unsustainable" and that the cost would ultimately be borne by public employees. Roberts noted that Wieners nevertheless voted for the methodology change,

Questioned about the methodology changes, David Rosen, the OLS's budget and finance officer, confirmed that the Christie administration had changed the pension contribution formula, and that the lower contributions "will have a downward effect" on the pension system's balance sheet in future years. So did Democratic analysts, and the state's actuarial reports indicate clearly that the methodological change was made at the direction of the Treasury Department's Division of Pensions and Benefits.

Christie's decision needs to be understood in the context of the negotiations between Christie and Democratic legislative leaders, notably Senate President Stephen Sweeney (D-Gloucester), over the controversial 2011 pension and health benefits overhaul, which was needed because the pension system was in danger of collapse after 15 years of Democratic and Republican governors and legislatures skipping tens of billions of dollars in annual pension payments.

The law, which passed over the opposition of the New Jersey AFL-CIO and the state's public employee unions, eliminated cost-of-living increases for pension recipients, raised the retirement age from 62 to 65, and required teachers, police, firefighters, and state and local government employees to contribute more toward their pensions.

#### Seven-Year Ramp-up

The law gave the state seven years to ramp up to the full actuarially required pension contribution needed to make the pension system solvent -- a decision that meant that New Jersey's unfunded pension liability would continue to grow over that period. In the first year after passage of the new pension law, for example, New Jersey's unfunded pension liability for state and local governments grew almost \$5 billion to \$47.2 billion, and Christie projected it would hit \$54 billion by FY2018, the year the phase-in to full actuarial funding is complete.

Therefore, Christie and Democratic legislative leaders agreed that the state's actuarial payment would be determined as if public employees were still contributing to their pensions at the old rate of 5.5 percent for teachers and state and local government workers and 8.5 percent for uniformed public safety personnel -- rather than the new contribution rates of 6.5 percent that would increase to 7.5 percent by FY2018 for most government workers and the 10 percent contribution rate that kicked in for uniformed personnel in FY2011.

"The effect was to make the system a little healthier," Rosen said.

It was that agreement on how to calculate the "actuarially appropriate" phase-in of pension contributions that Christie broke.

"When the governor said on 101.5, 'I will make the actuarially appropriate contribution' to the pension system, he did not say he was going to change the assumptions so he could contribute less," one state fiscal expert said, explaining why OLS and Democratic pension experts were surprised "He wouldn't be changing the formula after three years of making pension contributions at the higher rate if he wasn't hundreds of millions of dollars short on his revenue forecasts."

Christie's decision to change the actuarial formula that determines pension payments enables him to lower the record \$1.676 billion pension payment that was included in the Fiscal Year 2014 budget he signed into law last June to \$1.582 billion. It also let Christie cut the expected FY15 payment from \$2.4 billion to \$2.25 billion.

By FY18, Christie's final budget and the last year of the seven-year phase-in, the pension formula change is expected to cut the state's required contribution from about \$4.2 billion to about \$3.9 billion -- which is the payment the state would actually be making this year if Christie and Democratic leaders had not agreed to a seven-year phase-in to actuarially appropriate funding levels.

Sidamon-Eristoff will have to address the changes in the pension-funding formula when he and the OLS's Rosen deliver their annual budget review and revenue forecasts to the Senate Budget Committee on April 1 and the Assembly Budget Committee on April 2.

Roberts noted that the new method of calculating pension obligations -- not the system that was in effect for FY2012, FY2013, and until it was changed, for FY14 -- is the industry standard.

The change in the state's pension-funding formula can be seen in an NJ Spotlight review of the various [2012 actuarial reports](#) that determine the state's required pension contributions for FY2014 for the Teachers' Pension and Annuity Fund, Public Employees' Retirement System, Police and Firemen's Retirement System and four other pension funds, along with five [2013 actuarial reports](#) that calculate FY2015 state pension contributions.

Actuaries Richard L. Gordon and Scott F. Porter of Milliman, a Wayne, PA, firm, clearly laid out the changes in the pension formula and their implication for the future health of the pension system in their February 27, 2014 report on the Teachers' Pension and Annuity Fund (TPAF), the state's largest pension plan.

The 2011 pension law sponsored by Sweeney and signed into law by Christie "increased the employee contribution rate from 5.5 percent to 6.5 percent effective October 1, 2011 and by 1/7 of 1 percent each following July 1 over the next 7 years until 7.5 percent is attained effective July 1, 2018. Typically, all member contributions are used as an offset in developing an employer's normal cost," Gordon and Porter wrote.

However, the Division of Pension and Benefits told Milliman in 2011 that the Christie administration and the Legislature had agreed to calculate the state's pension contribution as if employees were still making the old 5.5 percent contribution.

As the actuaries explained, "When Chapter 78 was passed, it was our understanding that the additional member contributions in excess of 5.5 percent would serve to reduce the unfunded actuarial accrued liability rather than serve as a direct offset to the State's Normal Contribution." In other words, as Rosen explained, the state agreed to make higher contributions in order to partially offset the fact that the decision to take seven years to ramp up to actuarially appropriate funding was deepening the state's unfunded pension liability.

This year, however, Milliman was instructed by the Division of Pension and Benefits to change the formula. "This valuation reflects a change in the treatment of the contributions in excess of 5.5 percent to now serve as a direct offset to the State's Normal Contribution for the fiscal year ending June 30, 2015," the actuaries wrote.

Furthermore, “this change was also applied retroactive to the 2012 valuation for determining the State’s Normal Contribution for the fiscal year ending June 30, 2014,” they explained.

It is that retroactive cut that accounted for \$49.5 million of the \$62.823 million that Sidamon-Eristoff sliced from the state’s contribution to the Teachers’ Pension and Annuity Fund to fill a \$694 million hole in this year’s budget; changes in salary assumptions accounted for the other \$13.3 million retroactive cut. A similar mathematical formula applied to the \$29.343 million cut in state payments to pensions for higher education and state government employees.

“The long-term impact of this change in treatment of member contributions in excess of 5.5 percent of pay is that fewer contributions will be made to TPAF each year in the future, resulting in an estimated decrease in the projected funded ratio in 30 years of approximately 10 percent, based on the current investment-return assumption and other assumptions and methods,” the actuaries warned.

Further, the Christie administration’s decision to put more than \$900 million less into the pension system through FY18 -- which will be Christie’s last budget -- will result in higher contributions being required in future years, because the pension system not only loses the \$900 million in contributions, but an expected annual return of 7.9 percent on that \$900 million in additional pension investments -- the expected rate of return certified by Sidamon-Eristoff.

Christie warned during his February budget speech and more recently in town meetings that he would take “extreme measures” to cut the state’s long-term pension and retiree healthcare obligations unless the Democratic Legislature found other cost savings.

Presumably, he was referring to more extreme measures than the pension formula changes he had already enacted, but the OLS has already stated that the governor’s powers would not allow him to declare a fiscal state of emergency over the pension issue, and states are precluded from filing for bankruptcy to get out from under pension contracts, as the city of Detroit did.

Sweeney and Assembly Speaker Vincent Prieto (D-Hudson) already have called Christie’s bluff, stating that they would not ask public employees to contribute more when it was the state government -- not government workers -- that had skipped billions of dollars in pension payments and was not yet paying its full pension obligation.

## Pressure building on Pew to cut ties with foundation

Public pension fund groups are pressuring the Pew Charitable Trusts to stop taking money from a foundation to finance Pew's Public Sector Retirement Systems Project.

The Laura and John Arnold Foundation, Houston, is contributing up to \$4.85 million over three years; that contract ends in December and may be renewed.

Some public pension fund association executives criticize the foundation's mission and funding recipients, which include some conservative and Libertarian groups that oppose public defined benefit plans.

"Pew's relationship with the Arnold Foundation does not pass the smell test," said Meredith Williams, Denver-based executive director of the National Council on Teacher Retirement.

In February, New York Public Broadcasting Service station WNET abruptly canceled a series on public pensions, called "Pension Peril," that was solely funded by the foundation to the tune of \$3.5 million. The money was returned.

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## Military Proposes Big Changes in Retirement Benefits

After years of silence on the intensely controversial issue of military retirement reform, the Pentagon on Thursday unveiled a detailed proposal for fundamental, far-reaching changes to the current pension system, Military Times has learned.

The changes would preserve the current system's defining feature of a 20-year, "cliff-vesting," fixed-income pension. But it would ultimately provide smaller monthly checks, according to documents obtained by Military Times.

To compensate for that, the new proposal would offer three new cash payments to be provided long before old age — a 401(k)-style defined contribution benefit awarded to all troops who serve at least six years; a cash retention bonus at around 12 years of service; and a potentially large lump-sum "transition pay" provided upon retirement to those who serve 20 years or more.

In the broad view, the new plan would lower the total economic value of the military retirement package. But maybe not by that much. Details vary, but several options show a roughly 10 percent reduction in cumulative lifetime payments.

Pairing that long-term reduction with the new cash payments is a strategic decision by Pentagon personnel experts, based on the notion that troops would prefer a plan that gives them more money up front to reduce the impact of smaller pension payments later in life.

"When compensation is paid out sooner, it has more value to the typical member who is assessing whether to continue in the military," according to a 44-page report outlining the new proposals.

Less than 20 percent of service members ever see any retirement benefits under the current system, so the new proposal may be welcomed by the vast majority of troops who do not plan to stay for a 20-year career.

What is sure to be one of the most controversial options outlined in the report would give "working age" retirees only a "partial benefit" pension check, forcing them to wait until a traditional retirement age, probably age 62, until becoming eligible for more robust monthly checks that reflect the "full benefit."

That is a recognition that most service members go on to second careers in the civilian world before leaving the workforce and retiring for good.

Two options

The basic building blocks of the new proposal are the cash incentives that would come while a member is still in uniform and right at retirement:

- For all troops, DoD would set up a Thrift Savings Plan account, the federal government's 401(k)-style savings account. Starting after two years of service, DoD would provide an annual direct deposit equal to 5 percent of basic pay. No contribution is required from service members, although they could contribute more on their own if they chose to. Full ownership of these accounts would transfer to individual service members after they reach six years of service, with the money available for withdrawal beginning at age 59½.

Speaking hypothetically, Pentagon officials say that if such accounts had been in effect for the past 20 years, a retiring E-7 would have accumulated a total of about \$37,600 in his or her account, while a retiring O-5 would have an account worth about \$76,200. Both figures assume that the service members made no additional contributions, and that the annual rate of return on the investment was about 5 percent.

- The services would offer a retention incentive payment for troops who clear a midcareer milestone, most likely the 12-year mark. Also known as a "continuation pay," this bonus might be equal to two months' pay for enlisted troops and six months' pay for officers. The individual services would control this payment, and it could vary by career field if manpower planners need to bolster retention in specific pockets of the force.
- Upon final separation, troops who have served at least 20 years would get lump-sum transition pay. That might be as much as three years basic pay under scenarios that substantially reduce pension checks. It might be less than one year's basic pay under options that do not reduce the pension income as much. The size of this payment could be standardized under law to make it the same regardless of service or career field.

Building on those three incentives, the Pentagon report offers two "options" for a complete retirement overhaul, both of which involve reducing the "multiplier" used to calculate military retirement pay.

One option would be structured similar to the existing system: Retirees would begin collecting pension checks immediately upon separation and continue receiving those payments, with minor annual cost-of-living adjustments, for life.

A second — and potentially far more divisive — option would offer similar cash benefits up front but would provide a two-tiered pension with only "partial" monthly payments immediately after separating from the military, probably capped at 25 percent of late-career basic pay. This "partial benefit" would shift to a more generous full benefit after an individual reaches a traditional retirement age, probably 62.

The new Pentagon report does not appear to favor one approach over the other, saying only that research shows either option is workable and would not damage retention or force structure.

Under both alternatives, the report notes, retirees could expect their income in old age to rise after their TSP money becomes available for withdrawal at age 59½.

#### New multipliers

The fixed-income retirement system is based on a yearly multiplier, currently 2.5 percentage points. That means a member's retirement pay equals 2.5 percent of their average basic pay over their three highest earning years — almost always the last three — for each year of active-duty service. Serving 20 years results in a monthly check equal to 50 percent of that "high-three" average.

A central question about the new retirement proposals is where to set the new multiplier.

Under one option that offers full benefits immediately after retirement, the multiplier would be reduced to 1.75 percent, giving troops retiring after 20 years monthly checks worth about 35 percent of their final high-three average. For example, an E-7 retiring after 20 years initially would get an annual retirement income of about \$19,970, which would rise to \$23,508 later in life, when additional income from the Thrift Savings Plan becomes available. Under the current system, that E-7 would get \$24,640 per year

For an officer retiring at the O-5 paygrade after 20 years, this option would result in an annual retirement income of \$37,884 during working-age retirement, rising to \$45,375 later when additional income from the Thrift Savings Plan becomes available. By comparison, that same officer under the current system would receive \$46,748.

Under the second option offering only a partial benefit for working-age retirees, the yearly multiplier might remain at 2.5 or be lowered to 2 percentage points, Pentagon documents show.

Under the more aggressive version that lowers the multiplier to 2.0, troops retiring after 20 years would receive about 40 percent of their high-three basic pay average after age 62. Before then, the partial benefit plan would give retirees pension checks capped at 25 percent of their high-three basic pay average.

In effect, under that option, an E-7 retiring after 20 years would get initial annual retirement income of about \$18,117, which would rise to \$26,946 later in life after full benefit checks kick in and additional income from the Thrift Savings Plan becomes available.

The partial benefit option offers a higher income in old age when compared to the current system, which would give that same E-7 about \$24,640 per year, mainly because it would be paid for a far fewer number of years.

For the example of an officer retiring at the O-5 pay grade, that "partial benefit" system would result in an annual income of \$34,369 during his or her working-age retirement, which would rise to \$52,020 in old age after "full benefit" checks kick in and additional income from the Thrift Savings Plan becomes available. Again, compared to the current system, that "partial benefit" offers a higher income in old age.

An important difference between the two options involves the "transition pay." Under the "partial benefit" plan that reduces retirement pay during the "working age" years and increases it at age 62, DoD would offer a generous lump-sum transition pay that amounts to about 2 1/2 or three years of basic pay. Under the other option that more closely resembles today's system, transition pay would probably be equal to one-half or three-quarters of one year's basic pay.



### A deeper analysis

The proposals are detailed in a report prepared by the Defense Department's Personnel and Readiness Office and sent on Thursday to Capitol Hill and also to the Commission on Military Compensation and Retirement Modernization, which is conducting a detailed study of military pay and benefits.

The proposals are not formal recommendations and are not included in the Pentagon's 2015 budget proposal. Making public the detailed analysis, known inside the Pentagon as a "white paper," is intended only to inform public debate on a politically delicate issue that could have far-reaching effects on military retention.

"These are the department's views of potential options for modernizing retirement," said a senior defense official who helped write the report.

The proposal is based on a deeper level of analysis than other plans drawn up outside the Pentagon. Manpower experts used complex computer models to help gauge how subtle adjustments in compensation affect troops' decisions about their own careers.

"Unlike some of the proposals in the past, we were able to model various concepts to determine their impact on recruitment and retention," the senior defense official said.

Those retention models show that previous proposals calling for the elimination of the fixed-benefit pension and replacing it entirely with a 401(k)-style investment account would have a "devastating" effect on retention.

Still, the Pentagon's top brass believes the military retirement system has become too expensive and may soon begin to inhibit spending on weapons modernization and research. Today for every dollar paid in current compensation for active duty troops, the federal government sets aside 44 cents to cover the accrual cost of future benefits.

Under the current system, the total lifetime value of an enlisted retirement package is usually at least \$1 million and for officers it is often more than \$2 million.

Defense officials acknowledge that the total savings from the new proposals would be modest, especially in light of the Pentagon's current budget environment that emphasizes large-scale cost reductions to meet near-term spending caps imposed by Congress.

Rather, the personnel experts who developed the proposal aimed to make it more efficient, to integrate the active- and reserve components under a single system and to give manpower planners more levers to shape a future force that requires an increasingly complex mix of skills and experience.

"Saving money was not of paramount importance," said another defense official who worked on the proposal. "It was of equal importance to making sure our members maintain a very good retirement and, secondly, giving our force managers a retirement system that will be able to maintain the force and give them some additional flexibility.

"We were not trying to squeeze as much money as we can out of this thing, the defense official said.

The proposals include changes to retirement for active-duty troops, reservists, wounded warriors and also revamps the survivors benefit program for retirees.

Any changes to military retirement would require approval from Congress, and lawmakers are unlikely to take any action until after the military compensation commission submits its formal report, due next February.

Top defense officials strongly support grandfathering any and all of today's troops under the current system.

Yet defense officials also support giving today's troops a choice to "opt into" the new system. Officials believe it might appeal to young enlistees or junior officers who have been in the military for only a year or two and remain far from certain about whether they plan to stay in for a full 20 years — and would see at least some retirement benefit for serving as few as six years.

"The analysis conducted for this review suggests that a large fraction of personnel would opt into the new system," the report said.

Officials acknowledge that fewer troops are likely to opt into a system that offers only "partial" retirement pay for working-age retirees. In other words, the belief is that troops would be more likely to opt into a new system with TSP contributions and transition pay if they can still count on a "full benefit" upon leaving service.

"Nonetheless, the number of members who choose to participate in a new system would be sufficient to generate considerable cost savings in the initial years after the system is implemented," the report said.

Under all of the various plans, the cost of funding military retirement would go up temporarily as the Pentagon would have to meet new up-front commitments for the Thrift Savings Plan contributions for all troops, retention payments around the 12-year mark and the "transition pay" for departing troops.

But in the long run, the new retirement plan would cost taxpayers less, with the savings growing over time as grandfathered troops retired and the force becomes filled with younger troops recruited under a new policy. Full savings would manifest only after about 30 years.

The Pentagon's proposal could cut year-in, year-out accrual costs by more than 15 percent under the most aggressive options. The current retirement program costs taxpayers about \$25 billion annually in accrual costs. The new proposals would ultimately reduce that by between \$1.5 billion to \$4 billion, or between 5 percent and 15 percent.

That amount of annual savings amounts to less than one percent of the overall defense budget, which this year is more than \$500 billion.

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## Private Sector

### PBGC Final Rule Makes Significant Changes to Premium Due Dates, Rates and Payments

The Pension Benefit Guaranty Corporation (PBGC) issued a final rule making significant changes to the premium due dates, variable-rate premiums and penalties for late payments within its regulations on premium rates and payment of premiums, among other changes. The final rule is generally effective for 2014 and later plan years.

#### Practical Law Employee Benefits & Executive Compensation

On March 10, 2014, the Pension Benefit Guaranty Corporation (PBGC) issued a final rule making significant changes to its regulations on premium rates and payment of premiums. The final rule, which is very similar to the proposed rule issued in July of 2013,:

- Creates one uniform due date (generally, October 15th) for premium filings for plans of all sizes. The final rule provides a transition rule for 2014 for small plans (see Transition Rule for Small Plans).
- Makes changes to variable-rate premium rules, including:
- creating a "look-back" rule for small plans that bases the premium on prior-year data; and
- exempts most plans from the premium for any year in which it completes a standard termination, or, for small plans, for the first year of coverage.

- Provides for relief from penalties for late payment.
- Makes other changes, including coordinating changes with MAP-21.

The final rule is generally effective for 2014 and later plan years. The exemption from the variable rate premium rules for a plan closing in a standard termination is applicable for a plan that completes distribution of its assets in compliance with the single-employer termination regulation on or after April 10, 2014.

### Due Date Changes

The final rule amends the due date rules in its regulations on premium rates and payment of premiums by:

- Unifying due dates for plans of all sizes (see Uniform Due Dates).
- Modifying the due date for terminating plans (see Special Due Date for Terminating Plans).
- Modifying due dates for new and newly covered plans (see New Plan Due Date Modifications).

### Uniform Due Dates

Premium due dates currently depend on plan size, with large, mid-size and small plans all paying flat-rate and variable-rate premiums according to different schedules. The final rule eliminates the current system of three premium due dates and returns to one uniform due date for both flat-rate and variable-rate premiums of plans of all sizes.

For calendar-year plans of all sizes, the due date will be October 15. However, the final rule provides a transition rule to give small plans more time to adjust to the new rules.

For small plans, the uniform due date causes a timing issue under current rules (because small plans value plan benefits at the end of the year). To solve this problem, the final rule creates a look-back rule for small plans that values plan benefits based on prior-year data (see Look-back Rule for Small Plans).

### Transition Rule for Small Plans

Shifting immediately from the old due date schedule to the new schedule would result in two premium due dates for small plans in the initial transition year. To avoid the doubling up of premiums for 2014, the final rule provides a one-time extension by extending the transition year due date by four months (from October 15, 2014 to

February 15, 2015, for calendar-year plans) for plans that would otherwise have two premium due dates in 2014.

This means a small plan would pay its 2014 premiums on February 15, 2015 and its 2015 premiums on October 15, 2015.

The final rule includes a chart illustrating the due dates for plans of all sizes in 2014 and 2015.

In addition, a 60-day penalty waiver is available in cases of financial hardship.

### Special Due Date for Terminating Plans

Under current rules, for a plan terminating in a standard termination, the final premium may be due months after the plan is terminated. The final rule creates a new premium due date for terminating plans that coordinates with the final step in a standard termination, a plan's filing of the post-distribution certification under PBGC Regulation 4041.29. A plan administrator of a terminating plan must file this certification between 30-90 days after the last benefit distribution date.

Under the final rule, the special premium due date for a terminating plan's final year would be the earliest of:

- The normal premium due date.
- The date when the post-distribution certification is actually filed.

This is a simplified version of the special due date created under the PBGC's proposed rule (see [Legal Update, PBGC Proposed Regulations Simplify and Coordinate Premium Rate and Payment Rules: Special Due Date for Terminating Plans](#)).

Practically this accelerates the premium deadline for terminating plans that close out within the first six and one-half months of the final year. However, the final rule also exempts plans from variable-rate premiums for the final year (even if the termination date comes within that year), which reduces the burden of computing a variable-rate premium under this accelerated deadline (see [First-year and Final-year Variable-rate Premium Exemptions](#)).

### New Plan Due Date Modification

The current premium payment regulation includes a special due date provision for new and newly covered plans. The final rule modifies the current provision to:

- **Restore Alternative Due Dates for Newly Covered Plans.** For newly covered plans, the PBGC restores the alternative due date of 90 days after pension plan termination

insurance coverage begins under Title IV of ERISA (which was eliminated under the Pension Protection Act of 2006 (PPA)).

- Provide Alternative Due Dates for New Small Plans Created in Consolidations and Spin-offs. The final rule provides an alternative due date for new small plans resulting from non-de minimis consolidations and spin-offs. These plans are excluded from the new look-back rule that bases a small plan's variable-rate premium on prior-year data and instead must pay a variable-rate premium based on current-year data (see First-year and Final-year Variable Rate Premium Exemptions).

### Variable-rate Premium Changes

The final rule makes several changes to variable-rate premiums, including:

- Introducing a look-back rule for small plans (see Look-back Rule for Small Plans).
- Adding and expanding exemptions from the first-year and final-year variable-rate premiums (see First-year and Final-year Variable-rate Premium Exemptions).
- Clarifying the application of the loading factor to the calculation of the premium funding target for plans in at-risk status (Clarifying Calculation of Premium Funding Target for At-risk Plans).

### Look-back Rule for Small Plans

The final rule requires small plans to determine unfunded vested benefits (UVBs), on which variable-rate premiums are based, by looking back to data for the prior year. (It would not involve any "rolling forward" or other modification of prior year data as was the case under regulations that were in place pre-PPA.) This "look-back" rule would apply only to the variable-rate premium, not to the flat-rate premium.

A small plan is defined to include a plan with either:

- A participant count for the premium payment year of 100 or fewer (the proposed regulation used a participant count of "up to 100").
- A funding valuation date that is not at the beginning of the premium payment year.

Basing this definition on a plan's participant count in the premium payment year (rather than the year prior to the premium payment year) will exclude many new or newly covered plans (which have no prior year) from using the delayed small plan due date that is permitted under current rules for their first year. However, it does align a small plan's premium due date with the Form 5500 due date (as typically extended) and corresponding valuation.

### First-year and Final-year Variable-rate Premium Exemptions

Because a new plan does not have a prior year to look back to, the final rule exempts small plans that are new or newly covered from the variable-rate premium.

The PBGC considers plans created by consolidation or spin-off to be new plans. To avoid creating incentives to spin-off underfunded small plans to avoid paying variable-rate premiums, the PBGC proposal excludes non-de minimis consolidated or spun-off plans from this exemption and instead bases their variable-rate premiums on current year data, with an alternative due date available (see [New Plan Due Date Modifications](#)).

The final rule also expands the current exemption from the variable-rate premium to include the year in which a plan closes out, regardless of when the termination date is. This is conditioned only on the completion of a standard termination.

### Clarifying Calculation of Premium Funding Target for At-risk Plans

ERISA Section 303(i)(1)(A)(i) requires the use of special actuarial assumptions in calculating an at-risk plan's funding target, including that a "loading factor" (described in ERISA Section 303(i)(1)(C)) be included in the funding target of an at-risk plan which has been considered at-risk for two of the past four years. There is some ambiguity under the current premium rates regulation regarding the term "participant" in the loading factor calculation for at-risk plans, including:

- Whether the term "participant" in the loading factor provision is meant to refer only to vested participants in the premium context.
- How participants are counted for purposes of the premium rates regulations and the IRS regulations on special rules for at-risk plans.

The final rule resolves this ambiguity by providing that the participant count to use in calculating the loading factor to be reflected in the premium funding target is the same participant count used to compute the load for funding purposes.

For more information on PPA funding rules for at-risk plans, see [Practice Note, Qualified Retirement Plans in Mergers & Acquisitions: PPA Funding Rules](#).

### Penalty Changes

The final rule makes a number of changes to the PBGC's penalty structure, including:

- Lowering the Self-correction Penalty Cap. To encourage voluntary payment of unpaid or underpaid premiums, the proposal caps the self-correction penalty at 50% of the unpaid amount.
- Expansion of Penalty Waiver Authority. The appendix to the regulations states that PBGC may waive all or part of a premium penalty but that PBGC intends to exercise this waiver authority only in "narrow circumstances." The PBGC proposal removes the reference to narrow circumstances to avoid an implication that PBGC considers its waiver authority more narrowly circumscribed than in fact it does.
- Codification of Seven-day Penalty Waiver Rule. The proposal codifies a policy, announced in September 2011, that for plan years beginning after 2010, it would waive premium payment penalties assessed solely because premium payments were late by seven days or less.
- Removal of Unneeded Flat-rate Safe Harbors. The proposal eliminates the flat-rate safe harbor provisions from the premium payment regulation, since the change in due dates (see Uniform Due Dates for Plans of All Sizes) will render them unnecessary.

#### Other Changes

The rule finalizes several other changes made by the proposed regulations, including changes:

- To the variable-rate premium cap.
- To the exemption for standard terminations.
- For liability for premiums in distress and involuntary terminations.
- To the definition of newly covered plan.
- To make consistent changes to the premium rates regulations due to MAP-21 (for more information on MAP-21 and pension plans, see [Legal Update, IRS and PBGC Issue Guidance on Pension Funding Stabilization Issues for Defined Benefit Plans under MAP-21](#)).



## U.S. Ranks 19th On Retirement System

Nations best equipped to meet the needs of future retirees emphasize simplicity of retirement plan design, according to a global retirement index issued by Natixis Global Asset Management.

The Global Retirement Index survey provides some idea of where the United States ranks relative to other nations with regard to meeting retirement needs through its retirement system.

This year, the U.S. – sixth highest in per capita income – finished a relatively low 19th, behind several European nations, Australia, New Zealand, Canada and South Korea. The U.S. was ahead of Israel. The survey also found New Zealand, Iceland and South Korea improved the most in the last year.

One of the defining elements of a good retirement system is that it is relatively simple in overall design and structure, the authors of the survey said.

John T. Hailer, chief executive officer of Natixis Global Asset Managing in the Americas and Asia, said that some policies and practices in some regions “could hold valuable lessons for other nations, such as the U.S., which needs to shore up its retirement system.”

Retirement plan experts have testified to the unnecessary – and growing – complexity that hobbles the U.S. system.

In the U.S., the individual retirement account (IRA) sphere alone is awash in acronyms that few people understand and that fewer still – except for tax attorneys and financial advisors – have any clue about when it comes to tax implications.

IRAs, for example, have cousins in the form of Roth IRAs, but both carry different tax implications with regard to contributions and distributions.

Joining the IRA family from the employer-sponsored world are SIMPLE IRAs for small employers, and supplementing executive retirement plans (SERP) for top managers working for large corporations.

Add those to the alphabet soup that comes with defined contribution plans, 401(k)s, 403(b)s and 457s, and it's clear that the U.S. retirement system has grown into a patchwork of plans to meet the narrow individual circumstances of separate classes of employees.

The gradual “layering” of plans onto the existing retirement network has added cost and complexity, yet huge swaths of workers in the U.S. are still not covered. New bills pending in Congress aim to fill those gaps, but also add new layers of options.

Retirees in countries that enjoy the greatest financial security in retirement live in Switzerland, Norway, Austria, Sweden, Australia, Denmark, Germany, Finland and New Zealand.

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## Funding ratios soar in 2013 for 100 largest corporate pension plans

The aggregate funding ratio for the pension plans of the 100 largest publicly traded corporations grew to 89% from 77% in 2012, according to a report from Towers Watson.

The ratio improved because of significant asset growth due to strong investment returns for the year, working in tandem with reduced plan liabilities caused by higher interest rates, based on the companies' recently released 10-K filings with the Securities and Exchange Commission.

“I think companies can breathe a little easier,” said Dave Suchsland, senior consulting actuary at Towers Watson, in a telephone interview. “I think their memories are still relatively short but they understand the prospects to the levels we previously had (before 2008) are not impossible.”

The 100 plans' total assets rose to \$1.049 trillion as of Dec. 31, up from \$1.006 trillion at the end of 2012, an increase of 4.2%. However, the growth was less than the aggregate rate of return for the year of 9.8% due to some plans offering voluntary lump-sum buyouts and purchasing group annuity contracts from insurance companies, which made assets, as well as liabilities, lower.

The total projected benefit obligation dropped to \$1.175 trillion from \$1.302 trillion the previous year, due to the average discount rate increasing 83 basis points to 4.85% during the year ended Dec. 31.

More plans had surpluses in 2013 than at any time since 2007, with 22 plans recording funding ratios of more than 100% in 2013, compared to five in 2012.

Fifty-one of the top 100 plans had funding surpluses in 2007, the final full year before the financial crisis.

Also, only five of the top 100 plans had a funding ratio of less than 70% at the end of 2013, compared to 26 plans at the end of the previous year.

Despite the improvement, companies have to face higher PBGC premiums and updated mortality tables from the Society of Actuaries reflecting higher life expectancies than previously estimated, increasing plan liabilities.

“When you add the (higher) PBGC premiums and new mortality tables, (companies) will really like the value proposition for doing a lump sum offering ... and I think more companies are going to do that,” Mr. Suchsland said.

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## Celebrating Women: A Look at Women's Retirement Security

Every March we celebrate the profound impact women continue to have on American and world history. While Women's History Month is usually the designated time of year to robustly commemorate the contributions women have made to society, we also think it's a good time to take a look at the state of women's retirement security. After all, life after retirement is very important to "women's history."

First, let's be clear, the retirement picture is dismal for both men and women. But compared to men, women's retirement security is often less than adequate.

The United States Department of Labor reports married women tend to outlive their spouses by two years once they reach age 65 — that's two whole years of additional savings needed to cover the cost of living expenses that some do not factor in. Women also tend to take a more conservative approach when it comes to saving for retirement. Simply put, women do not invest in high-risk stocks because of the volatility of the stock market.

Another factor contributing to the bleak retirement outlook is women often delay saving for retirement. The Department of Labor also reports only 45 percent of the 62 million salaried women working in the United States contribute to a retirement plan.

Here's one reason why: Women, more often than men, are employed in part-time jobs and do not qualify for company retirement plans.

This means there is no retirement contribution on either party's behalf. Additionally, women often leave the workforce to care for their families which results in fewer years worked and fewer wages available to contribute to retirement.

But the bottom line is delaying saving for retirement is detrimental to women's retirement security. Fortunately, with just a few adjustments, women can get themselves on track to securing a healthy nest egg.

To live comfortably through the golden years, early and often retirement planning is crucial for financial sustainability. Women should put themselves in position now, as much as possible, to avoid hardships and headaches later.

The National Institute on Retirement Security issued "[Shattering the Retirement Glass Ceiling: Women Need a Three-Legged Stool](#)," which examines the specific challenges facing women in retirement and assesses the policies that may help increase retirement security for women.

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## Boeing ending pensions for some; About 1,000 nonunion workers will be affected in North Charleston

Pension plans for 68,000 nonunion Boeing workers, including about 1,000 in North Charleston, will end in 2015, the company announced Thursday.

Participating employees will be switched to a 401(k)-style retirement savings plan instead on Jan. 1, 2016.

The decision affects about 15 percent of the 6,700 direct-hired Boeing South Carolina workers in North Charleston, company spokesman John Dern said. The reason it's relatively few is that all Boeing employees hired after 2009 are already part of the defined-contribution model, he said. Of course, many in Charleston fall into that category since they are relative new hires.

All benefits earned in the pension plan before the transition will be paid to employees in retirement, and the company will continue to match employee savings in an existing 401(k) plan. Retirees already receiving pension benefits aren't affected.

The aerospace and defense giant has been moving away from pension plans to hold down costs and remain more competitive against French airplane-building firm Airbus. The move helps Boeing to better predict and manage financial risks, the company said in a statement.

Our objective in making this transition is twofold: continue providing an attractive, market-leading retirement benefit contributing to employees retirement security, while also assuring our competitiveness by curbing the unsustainable growth of our long-term pension liability, said Tony Parasida, a Boeing senior vice president.

Similar changes were recently included in an eight-year contract extension ratified in January by members of the company's biggest union, the International Association of Machinists and Aerospace Workers District 751 in Seattle and the IAM District 837 in St. Louis.

The narrow vote came with the promise that Boeing would build its new long-range passenger jet, the 777X, and its composite wings in the Puget Sound area after Boeing threatened to move the work elsewhere if the union didn't agree to the new contract.

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