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.

Inside This Issue

Public Sector/Government Plans

Morningstar Releases Its 2013 Edition of The State of State Pension Plans

We are pleased to announce the release of our annual state pension report, The State of State Pension Plans 2013.

The challenges and vulnerabilities facing government pension plans have continued to gain public prominence and attention in the past year. News sources regularly report on the impending crisis confronting municipal pensions while offering little clarity on how the issue should be analyzed. Often, the net effect seems to be more confusion than information. Identifying the critical truths and separating them from misinformation is a difficult task.

There is no denying that the pension liabilities of our state and local governments represent a significant financial challenge. Public pension costs and liabilities have escalated, pressuring the finances of state and local governments still hampered by the recession. Current data indicate that these pressures are expected to persist and perhaps even intensify. In terms of analyzing the importance of public pension liabilities, we believe pensions will play an integral role in determining a government's fiscal health and overall credit quality going forward.

Despite their importance, the inner workings of pensions are often not fully understood. To aid investors' knowledge of public pensions and their potential impact on governments, taxpayers, and investors, Morningstar has initiated ongoing, comprehensive research on the topic. Our annual State of State Pension Plans serves as the cornerstone of this endeavor.

State pension plans are particularly important, as they affect not only the states themselves but also local governments, indirectly. State plans are often umbrella systems covering employees of local governments as well as employees of the state. Additionally, pension liabilities, including the fiscal strain imposed by ballooning pension costs, may lead to reductions in intergovernmental aid to local governments.

To this end, Morningstar has analyzed current data for pension plans administered by each of the 50 states as well as the Commonwealth of Puerto Rico. The goal of this report is to present clearly and directly how each state's pension plan is structured, whom it covers, and how fiscally sound our analysis finds it to be. As most states have multiple plans, we aggregated data to determine the key ratios for all systems and plans to which each state contributes. Individual data for each plan are also included in the report, as individual plans can often have funded ratios that are above or below the aggregate for the respective state.

Report findings focus on the two key drivers of our pension analysis: the funded ratio and unfunded actuarial accrued liability (UAAL, or unfunded liability) per capita. We examine industry trends, upcoming regulatory changes, and potential red flags investors should watch for as well. While the traditional metric of the funded ratio is a good measure of the plan's ability to meet its obligations, Morningstar also highlights the UAAL per capita, which in our opinion is a useful metric not commonly applied in pension analysis. Similar to the calculation of debt per capita in credit analysis, the UAAL per capita represents the amount each person in the state would need to pay to fully fund this unfunded liability.

In aggregate, the state plans are 72.6% funded, with a UAAL per capita of roughly $2,600, although funded percentages and UAAL per capita vary dramatically among the states. Overall, state pension funded levels continued to decline in 2012, although the annual drop in funded percentage was moderate at 2.1%. Growth in liabilities outpaced that of assets, partially because entities are still absorbing asset losses from the recession, in accordance with the standard actuarial methods.

Several states have very strong pension systems. Six states have funded levels of more than 90%, and seven have UAALs of less than $100 per capita. Wisconsin remains the strongest system, with a 99.9% funded ratio and a UAAL of $18 per capita. Twelve states have funded ratios of at least 80%, which Morningstar considers strong and the Government Finance Officers Association recommends. On the other side of the spectrum, 26 states and Puerto Rico fall below Morningstar's fiscally sound threshold of a 70% funded ratio. Among states, Illinois continues to have the worst funded system at a 40.4% funded ratio and a $7,421 per capita UAAL. Puerto Rico falls far below Illinois, with an aggregate 11.2% funded level and a UAAL per capita of greater than $8,900. As of the most recent actuarial valuation, all three of the commonwealth's pension plans were projected to deplete their assets over the next few years.

Morningstar will update its State of State Pension Plans annually to keep investors informed about the fiscal health of each state's pension liabilities as well as any impact they might have on the state's overall credit quality.

EXCLUSIVE-U.S. city, county public pension levels sank in 2012-Wilshire

Funding levels for U.S. city and county public pension systems plummeted by 11 percentage points to 69 percent in fiscal 2012, pushed down by a poor performance of the stock market and ballooning liabilities, according to a report due to be released later on Tuesday.

The 106 plans studied in a report by Wilshire Consulting had an aggregate $173.6 billion of unfunded liabilities, with $560.6 billion of liabilities they needed to pay out but just $387 billion in assets.

Wilshire found that while the funds' assets rose by 2 percent, or $6.1 billion, liabilities grew even more - by 16 percent, or $78.1 billion.

"The fact that the liabilities did increase so much ... should be a wakeup call to these plans ... saying maybe (it's) time to take a look and see where this growth is taking place," said Russ Walker, vice president at Wilshire in California.

Swelling pension liabilities could be due to several factors, some of which can change over time: an aging workforce, employees with high salaries reaching the end of their service, richer benefit packages in exchange for salary concessions, Walker said.

The S&P 500 Index .SPX rose 1.7 percent from July 1, 2011, through June 29, 2012, the last trading day that fiscal year, according to Thomson Reuters data.

The study covered 106 city and county retirement systems and is based mostly on actuarial values on or after June 30, 2012.

The 10-year median return on the funds' assets was 6.7 percent, lower than their median assumed rate of return of 7.75 percent, which was the same assumed rate as the previous year, Wilshire found.

"Given the kind of volatility in the markets and lowered expectations for asset returns, one might think that discount rates would have gone even lower," Walker said. "They actually stayed where they were."

Wilshire, which provides investment consulting to public and private pensions, noted that public pension funds generally take a much longer view of their expected returns, often 30 years or longer.

The report also found that the pension funds were putting 61 percent of their assets into equities on average - compared with 65.9 percent five years before - with the rest in fixed income.

Among the cities and counties, however, asset allocation varied widely, with 20 funds putting more than 70 percent into equities, and another 20 putting less than 50 percent into equities, Wilshire found.

"You're seeing growth assets having a very strong year. We should see funding levels recover a fairly substantial amount by next year," Walker said.

Tue Sep 24, 2013 9:30am IST
By Hilary Russ

Moody's Proposes Making Pension Liabilities a Bigger Factor in Bond Ratings

States and localities with big pension liabilities could see changes to their overall bond rating if new rules proposed this summer by Moody's Investor Service are adopted.

Moody's is proposing giving more weight to pension liabilities and other long-term debts in its overall scorecards for rating general obligation (GO) bonds. The agency would increase the weight to 20 percent from 10 percent and decrease the weight for economic strength to 30 percent from 40 percent. Weights for governance and management (20 percent) and financial strength (30 percent) -- the other two factors in the way Moody's scores its GO ratings -- would stay the same. The step by Moody's is just the latest in what has become a marathon of changes by various organizations in recent years that aim to place a bigger emphasis on pensions' effect on fiscal health.

Interested parties and stakeholders have until Oct. 14 to submit comments to Moody's.

In its methodology paper, Moody's noted that debt burden trends are an indicator of a population's capacity to absorb additional obligations. In the event that a local government's capital needs are great, this may foretell future financial distress. Thus, a bigger weight should be given to such burdens when considering an overall GO rating. Moody's said in a release that it chose to reduce the weight on economic health because it recognizes that some local governments are either unwilling or unable to capitalize on the strength of their local economies (i.e., a city may not be able to raise taxes because of anti-tax sentiment).

But municipalities with a large unfunded liability may not necessarily see their rating automatically fall under the new rules, Moody's said. "We recognize that funding levels naturally will rise and fall as retiree activity diverges from actuarial assumptions, as benefits change, or as investment returns fluctuate. In the case of an unfunded pension liability, Moody's will examine the reason that it has arisen and the entity's ability and willingness to address it over a reasonable period of time, which is broadly defined to encompass the working life of the beneficiaries so that liabilities are not passed onto a succeeding generation."

Only if such an analysis showed a pattern of underfunding annual pension contribution requirements, would a large unfunded liability "be viewed as a negative credit factor because it is a claim on resources that reduces financial flexibility," Moody's said.

Moody's maintains GO ratings or issuer ratings for approximately 8,200 local governments: 2,960 cities, 864 counties and 3,362 school districts.

The methodology change, if kept intact, should bring more attention to dangerous unfunded liabilities earlier on in a municipality's downward spiral and potentially help retirees, said Frank Shafroth, director of George Mason University's Center for State and Local Government Leadership. He pointed to cities that have declared bankruptcy like Central Falls, R.I., where retirees had to give up half their pension income, and Detroit, where Emergency Manager Kevyn Orr has said pension cuts will be part of the restricting plan, and said that retirees have far less leverage in bankruptcy than out of it. If cities have more consequences for bad pension finance local officials may be more inclined to right the ship while it's still feasible.

"We all have a human responsibility to protect these people," Shafroth said.

The methodology proposal comes after a change Moody's made earlier this year to the way it calculates pension liabilities. In April, Moody's announced it would adjust pension debt using a long term bond index rate, a discount rate that would likely result in rates of return smaller than the 7 to 8 percent assumption over 30 years that most governments use in calculating their pension liabilities. The Governmental Accounting Standards Board (GASB) has also taken steps that have the effect of highlighting unfunded liabilities previously hidden in government financial reports. Beginning this year, net pension obligations must now be included as a liability on governments' balance sheets. Governments should also use what GASB considers a more reasonable discount rate – one that more accurately reflects the current rate of return (generally between 3 and 6 percent for most funds) rather than the higher, historic rate of return.

Breakdown of Moody's Rating Approach for Municipal GO Bonds
(Four key rating factors and 16 sub-factors)

1. **ECONOMIC STRENGTH**
   a. Size and growth trend
   b. Type of economy
   c. Socioeconomic and demographic profile
   d. Workforce profile

2. **FINANCIAL STRENGTH**
   a. Balance sheet/liquidity
   b. Operating flexibility
   c. Budgetary performance

3. **MANAGEMENT AND GOVERNANCE**
   a. Financial planning and budgeting
   b. Debt management and capital planning
   c. Management of economy/tax base
   d. Governing structure
   e. Disclosure

4. **DEBT PROFILE**
   a. Debt burden
   b. Debt structure and composition
   c. Debt management and financial impact/flexibility
   d. Other long-term commitments and liabilities

Top-performing public pension funds
Ranked by one-year return as of June 30, 2013

Rank	Pension fund	Return	Benchmark	Outperformance (basis points)
1	Oklahoma Teachers' Retirement System	17.40%	14.40%	300
2	San Bernardino County Employees' Retirement Association	15.05%	8.20%	685
3	Stanislaus County Employees' Retirement Association	14.60%	11.53%	307
4	Missouri Local Government Employees Retirement System	14.50%	9.10%	540
5	Nashville & Davidson County Metropolitan Government Employee Benefit Trust Fund	14.22%	10.99%	323
6	Minnesota Board of Investments	14.20%	12.90%	130
7	Dallas Employees' Retirement Fund	14.20%	13.10%	110
8	Kentucky Teachers' Retirement System	14.10%	12.90%	120
9	Louisiana Schools Employees' Retirement System	14.01%	13.48%	53
10	CalSTRS	13.80%	13.30%	50
11	Ohio State Teachers' Retirement System	13.70%		
12	Arkansas Teacher Retirement System	13.50%	13.50%	
13	Ventura County Employees' Retirement Association	13.20%	12.40%	80
14	Sacramento County Employees' Retirement System	13.20%	10.90%	230
15	Illinois Teachers' Retirement System*	13.20%	12.50%	70
16	Florida State Board of Administration	13.12%	12.01%	111
17	MassPRIM	12.70%	10.87%	183
18	Oregon Public Employees Retirement Fund	12.68%		
19	Alaska Teachers' Retirement System	12.59%		
20	Alaska Public Employee's Retirement System	12.50%		

21	CalPERS	12.50%		
22	Nevada Public Employees' Retirement System	12.40%		
23	Oklahoma Police Pension & Retirement System	12.34%	11.34%	100
24	New York City Retirement Systems	12.30%	11.30%	100
25	Michigan State Retirement Systems	12.20%	12.60%	-40
26	Hawaii Employees' Retirement System	12.00%	11.60%	40
27	Oklahoma Public Employees Retirement System	12.00%	11.00%	100
28	Virginia Retirement Systems	11.80%	11.1%	70
29	New Jersey Division of Investment	11.79%	10.96%	83
30	Connecticut Retirement Plans and Trust Funds	11.64%		
31	Wisconsin Retirement System Core Fund	11.20%	10.10%	110
32	Employees' Retirement System of Rhode Island	11.07%	11.29%	-22
33	Kentucky Retirement Systems	11.03%	11.21%	-18
34	Texas Employees Retirement System	11.00%	10.90%	10
35	New Mexico Educational Retirement Board	10.90%		
36	Colorado Public Employees Retirement Association	10.60%	11.70%	-110
37	Maryland State Retirement & Pension System	10.60%	8.60%	200
38	Alaska Permanent Fund Corp.	10.50%	11.40%	-90
39	Pennsylvania State Employees' Retirement System	10.30%		
40	Teacher Retirement System of Texas	10.21%	8.67%	154
41	North Carolina Retirement Systems	9.52%	8.40%	112
42	Houston Police Officers' Pension System	7.67%	12.11%	-444

Retiree Health Benefits May Be Harder to Cut If Court Ruling Holds

Retiree health benefits, commonly treated by governments as malleable when times are tough, may be harder to slash if a recent California Superior Court ruling holds. And according to one ratings agency, that means the financial implication for at least California cities (if not others outside of California) could weigh on debt burdens even further and hurt a government's ability to borrow.

The ruling was issued Sept. 13, when a California Superior Court judge struck down efforts by the city of Los Angeles to limit that city's contributions to retiree health care benefits. The judgment is limited to a small labor group (unions representing city attorneys, engineers and architects) who challenged the cost-saving initiative, which is likely to be appealed. But Moody's Investors Service calls the implications "significant" because the decision implies that the benefits have legal protections comparable to pensions.

In his analysis issued last week, Moody's Senior Vice President Eric Hoffman said the ruling will have a negative impact on Los Angeles' credit rating as well as San Jose as that city is also dealing with similar litigation. "Negative credit impacts could eventually hit many California municipalities looking to trim retiree health care commitments to rein in costs," he wrote.

Public employees in LA were contesting what's called the "freeze ordinance," a 2011 mandate that required employees to contribute 4 percent more of their salaries for other post-employment health benefits (OPEBs) or accept a plan that caps the city's contribution to health care insurance at $1,140 a month throughout retirement. The majority of the city's employee groups agreed to the increased contributions and monthly caps, saving the city an estimated $80 million in the current fiscal year. But Judge Luis Lavin agreed with the select unions contesting the ordinance, ruling that the health subsidies are a vested right and the city could not unilaterally change policy without providing relatively equal replacement benefits.

Hoffman notes that the question of whether health care retirement benefits are legally protected in a way similar to pensions "is sure to become an area of increased focus for municipal market participants." Certainly, said Doug Rose, president of the California State Association of County Retirement Systems, if the ruling stands it will prompt more caution in governments when outlining benefits to new employees.

"In Los Angeles, they found that it was a contract because of the way it was written," he said. "It stated the premium subsidy [OPEB benefit] 'will' be provided. So it was unequivocal."

Financially, the ruling is not expected to significantly damage Los Angeles's finances as the city is one of the few that prefunds its OPEB liabilities. According to a Pew Charitable Trusts study that looked at the country's 61 biggest cities, researchers found that in fiscal 2009, Los Angeles had 55 percent of its retiree health care costs funded and just three others were at or above 40 percent (Denver was 51 percent, the District of Columbia was 49 percent and Louisville was at 40 percent). The vast majority of cities were below 5 percent funded. Because OPEB liabilities have generally been viewed as non-binding, most governments have adopted a pay-as-you-go approach. But barring cuts in benefits, such an approach "could create large scale financial problems over the next couple decades if current cost trajectories and funding practices continue," Hoffman notes.

Rose adds that in the wake of the ruling, cities going forward will likely "be more thoughtful about the promises they'll make and about whether they can fund them."

But Josh Franzel, vice president of research for the Center for State & Local Government Excellence, said it is difficult to compare the binding qualities of healthcare benefits with pensions. Pensions are a relatively static benefit determined by a formula and an employee's salary. Health care coverage is more susceptible to outside forces.
"Especially with retiree health benefits, it's always changing anyway based on variables – the cost of benefits, the age of retirement, [for example]," Franzel said. "There's a lot more movement with employer subsidy."

The legal protections of pensions and OPEB vary state by state. Hoffman notes that in March 2013, in contrast to the Los Angeles decision, an Illinois circuit judge ruled that a constitutional clause protecting pension benefits did not extend to health care. Still, 12 other states have contract law similar to California's and could be impacted: Alaska, Colorado, Idaho, Kansas, Massachusetts, Nebraska, Nevada, Oklahoma, Oregon, Pennsylvania, Vermont and Washington.

"These states say that, for the courts to find they have a contract, you have to have an offer, an acceptance and both have to give up something in exchange," Rose said. "When you induce someone to come work for you by giving this promise, that's essentially a contract."

Private Sector

Kodak Leaves Bankruptcy Behind with its Pensions in Hand

Last week, there was a Kodak moment that all of the company's employees and retirees could be proud of.

On Tuesday, Eastman Kodak Co., known for its iconic film business, ended a 20 month bankruptcy proceeding with its two pension plans intact. That means the nearly 63,000 people covered by those plans will have a more secure retirement.

When companies seek bankruptcy protection it doesn't automatically mean that plans will be shut down and come to us. During Kodak's bankruptcy, we were on the unsecured creditors committee and we worked with them to ensure the plans would continue.

True, there have been times – far too many – when companies have entered bankruptcy and tried to unnecessarily shed their plans. Not Kodak. The company said they wanted to keep their plans going from the start and we applaud them for doing so.

By keeping its plans Kodak follows American Airlines, supermarket chain Great Atlantic & Pacific Tea Company, better known as A&P, and Houghton Mifflin Harcourt Publishing, which entered Chapter 11 to reorganize and exited with their plans ongoing.

We're here to provide a safety net for people in company pensions that can't continue, but only as a last resort. We always work with companies to help them keep their plans so retirees get all the benefits they earned.

Last year, our efforts kept more than $12 billion in unfunded pension benefits off our books and helped nearly 200,000 stay in their plans.

September 9, 2013

Pension funding relief is tempting but the price may be too high in the long run

The dramatic decline in interest rates since the 2008 financial crisis has played havoc with the funding levels of corporate defined benefit plans, raising required minimum contributions and forcing difficult decisions. The passage of the Moving Ahead for Progress in the 21st Century Act of 2012, known as MAP-21, brought much needed relief through a revised method for setting liability discount rates. These new discount rates greatly reduce required minimum contributions, but they lead to an interesting question: Are plan sponsors better off under the new contribution rules?

The 1st U.S. Circuit Court of Appeals in Boston ruled July 24 that a private equity fund could have joint and several liability for its portfolio companies' pension obligations if the fund holds a sufficient stake in the companies. While the appeals court did not define the size of a stake, legal experts say 80% is considered typical.

Sponsors that follow MAP-21 will have reduced minimum contributions for a period of time — typically four to six years. However, relief comes at a price: MAP-21 raises Pension Benefit Guaranty Corp. premiums for the 2013 plan year and beyond. Sponsors that contribute at the lower levels of MAP-21 might incur higher costs in the long run.

Prior to MAP-21, the present value of liabilities was calculated using segment rates aligned with a plan's liability cash flows. These covered years 1 to 5, 6 to 20, and 21 and above, and were based on trailing 24-month averages of yields on high-quality corporate bonds. Under MAP-21, however, the applicable rates are based on 25-year averages — with floors and ceilings that will gradually widen over the next four years. By the time permanent floors and ceilings are in place in 2016, we expect that 24-month rate averages will have moved inside the floors, eliminating MAP-21 relief.

MAP-21 also included a significant rise in PBGC premiums. The flat-rate premium rose by $7 per participant in the 2013 plan year and will rise by the same amount next year. Increases thereafter will be based on inflation. The variable-rate premium, applied to unfunded vested benefits, will more than double by 2015. While MAP-21 caps the variable premium at $400 per plan participant (indexed for inflation), the combined increases will be substantial for many plans.

The PBGC variable-rate premium will be based on funding values calculated using the old discount rates, not the higher MAP-21 rates. So lowering contributions to the MAP-21 minimums will result in higher premiums going forward.

We used scenario analysis to project the impact of different contribution levels under varying interest rate and return on assets assumptions, taking into account both MAP-21 rate stabilization and the higher PBGC premiums. The sample plan used in our scenario analysis had a funded status of 92% at the start of 2012, with typical liability and cash flow characteristics; we did not assume any actuarial smoothing or carryover/prefunding balances.

We calculated cash costs over a 10-year horizon with and without MAP-21. These costs had three components: minimum annual contributions, the new PBGC premiums and full recognition of accrued benefits at the end of the period using a projected Internal Revenue Service yield curve.

We then formulated three simple interest rate scenarios to measure the potential impact of changing bond market conditions:

- no change in rates over the 10-year horizon;
- “bear flattening” — curve flattening with an overall rise in yields; and
- “bull flattening” — curve flattening marked by declining yields.

Asset returns are obviously critical to plan funding. So we re-ran our analysis using ROAs ranging from 5.5% to 9.5%. These assumptions were held constant over the study horizon.

Our assumptions also included our sample plan sponsor's cost of capital (8%) and effective tax rate (35%), which we used to calculate the net present value of all three cost components using both pre-MAP-21 and post-MAP-21 valuations. This enabled us to identify situations where it was beneficial for the sponsor to maintain pre-MAP-21 contribution levels. These included every scenario where ROA equaled or exceeded 7.5%. In the bear flattening case, maintaining a pre-MAP-21 contribution policy was beneficial even with a 7% ROA.

The explanation for these results is simple: MAP-21 contribution levels resulted in higher unfunded liabilities, triggering higher PBGC premiums. These higher premiums offset the benefits of delayed MAP-21 funding, even in some cases where the ROA was below cost of capital.

Our analysis applied deterministic ROA and capital cost assumptions to a single plan with a particular liability and corporate profile. Changing the sponsor's circumstances could have produced different outcomes, some of which might not have supported maintaining pre-MAP-21 contribution levels.

Reducing the funded status of the plan, however, does not change the outcome if other assumptions are held constant. While a lower funded status results in higher contributions under both contribution policies, lower PBGC premiums still favor a pre-MAP-21 funding strategy.

MAP-21 offers welcome relief to plan sponsors. However, while the lower short-run contributions it requires might be tempting, we believe plan sponsors that can make contributions based on pre-MAP-21 valuations should give that option serious consideration.

Employers shift health coverage

Duke Energy and Walgreen Co., two major southwest Ohio employers, have joined the rush of companies shifting responsibility for finding insurance onto employees and retirees as health care costs climb.

Duke, the country's largest electric company, last week began notifying about 14,500 retirees of Duke Energy and predecessors or subsidiaries in North Carolina, South Carolina, Florida, Ohio, Indiana and Kentucky, The News & Observer of Raleigh reported Wednesday. The retirees previously worked for Duke Energy, Progress Energy, Carolina Power & Light, Cincinnati-based Cinergy, Florida Progress and others, and the changes apply to all Duke retirees except union members in Florida.

In a letter, the company told retirees it had observed double-digit annual increases in the cost of their health coverage.

"We are therefore announcing a change in the way retirees age 65 or older can purchase health coverage that we believe provides more plan options and better value," the company wrote.

Duke Energy plans to release details later, but retirees won't get the company's stipend unless they buy coverage from UnitedHealthcare for policies that take effect in January.

The move affects not only retirees ages 65 and older but also their spouses and dependents ages 65 and older who receive retirement benefits from the company or any of its predecessors or subsidiaries in six states.

Walgreen, the nation's largest drugstore chain, said Wednesday that it will send workers to a private health insurance exchange where they will pick from as many as 25 plans instead of having the company give them two to four options.

Employers normally pay most of the coverage cost, and Walgreen's contribution toward the benefit won't change. It said the move will give its workers more choices and help them become better consumers.

"I think the only way to drive down costs in the health care space is to have the consumer buying the health care be knowledgeable and educated and understand what they are buying, " said Tom Sondergeld, senior director of health and wellbeing for the Deerfield, Ill., company.

IBM, Time Warner, Caterpillar, General Electric, DuPont and others have made similar announcements. More companies are expected to follow the trend of offloading retirees from the company's responsibilities.

Michael Suttman, president of McGohan Brabender, a Moraine company which helps businesses implement benefit programs, thinks more of both of these kinds of announcements in coming years.

"That will obviously be dependent on the success of the larger companies," Suttman said. "They will set the pace for how the market goes."

Walgreen's action in particular can be likened to what companies have done for decades, moving from defined benefit retirement plans to defined contribution plans, he said.

"It's kind of a reflection of a change in benefits that we've been seeing for years," Suttman said. "It's the 401K'ing of medical plans."

Employers have struggled for years with health care costs that climb faster than inflation and consume growing portions of their budgets each year. More are starting to veer from the decades-old practice of offering workers only a plan or two with benefits the employee might not want.

The alternative, called defined contribution health insurance, involves giving employees a set amount of money and then letting them pick their own coverage through a private marketplace or exchange that helps them sort out the choices.

The switch can make the employer's health care costs more predictable. But it also means workers who are used to having their coverage chosen for them could wind up with big medical bills and inadequate coverage if they don't pick wisely.

The exchanges are similar to the public exchanges or marketplaces that will debut next month for coverage that starts in 2014 as part of the health care overhaul, the massive federal law that aims to cover millions of uninsured people.

Walgreen runs more than 8,100 drugstores nationwide and provides health coverage for about 180,000 employees and dependents. It also will use Aon Hewitt's exchange for coverage that starts next year.

Aon Hewitt started offering its private exchange last year, and has about 200,000 people covered through it in 2013. It expects that total to triple to more than 600,000 people for coverage that starts next year. The consultant said it has 18 companies, each with more than 5,000 employees, lined up for next year.

Actuaries Encourage Employers to Consider Offering Retirement Income Programs

Society of Actuaries' Research Report Focuses on Retirement Income Generator Options

Retired workers can easily spend assets at an unsustainable rate when there is no retirement income plan in place, which further exposes them to inflation risks, market volatility and the risk of outliving their assets. While employer sponsored retirement income options are not yet widespread among defined contribution plans, employers are in an advantageous position to help their retiring employees by offering retirement income options. The Society of Actuaries (SOA) and the Stanford Center on Longevity released the research report, "The Next Evolution in Defined Contribution Retirement," to equip employers with more information about retirement income generators.

The report provides employers and plan sponsors with a roadmap on how and why to implement a retirement income program. The report identifies annuities and systematic withdrawals as retirement income generators to consider, as they produce higher amounts of retirement income than simply investment income. "It is important for people to evaluate all of their options for a lifetime paycheck and to set clear goals of what their retirement plans need to achieve," said actuary Steve Vernon, FSA, MAAA, consulting research scholar for the Stanford Center on Longevity. "Different retirement income methods produce significantly different amounts of income depending on the method chosen. Employers can help retiring employees understand the pros and cons of each method as well as the amount of retirement income, so retiring employees can make informed decisions."

As part of the SOA's report, Dr. Wade Pfau of The American College, developed stochastic forecast models on the tradeoffs of the different retirement income generators. The analysis shows that various retirement income generators produce significantly different amounts of income throughout retirement, and react differently to favorable and unfavorable economic scenarios.

"Using risk models, actuaries can provide employers and retirees alike with insights on the significant outcomes and risks for retirement plans in a down market," said SOA President Tonya Manning, FSA, MAAA, EA, FCA. "There is a clear opportunity for employers to help their workforce prepare for the future and this report is designed to inform employers of the retirement plan options." A retirement income program might be a low-cost benefit improvement that delivers significant value to older workers. By offering retirement income solutions with institutional pricing instead of retail pricing, employers can significantly increase the amount of retirement income that their employees may receive. Employers will benefit from offering retirement income options through enhanced reputation as a desired employer and corporate citizen, improved worker morale and lower administrative costs, among other benefits. "A cultural shift is needed to get employers and plan sponsors to include retirement income options as part of defined contribution plans," said actuary Anna Rappaport, FSA, MAAA, and Chair of the SOA's Committee on Post-Retirement Needs and Risks. "The report discusses retirees' needs and plan sponsors' concerns for building a retirement income mechanism to prevent outliving assets."

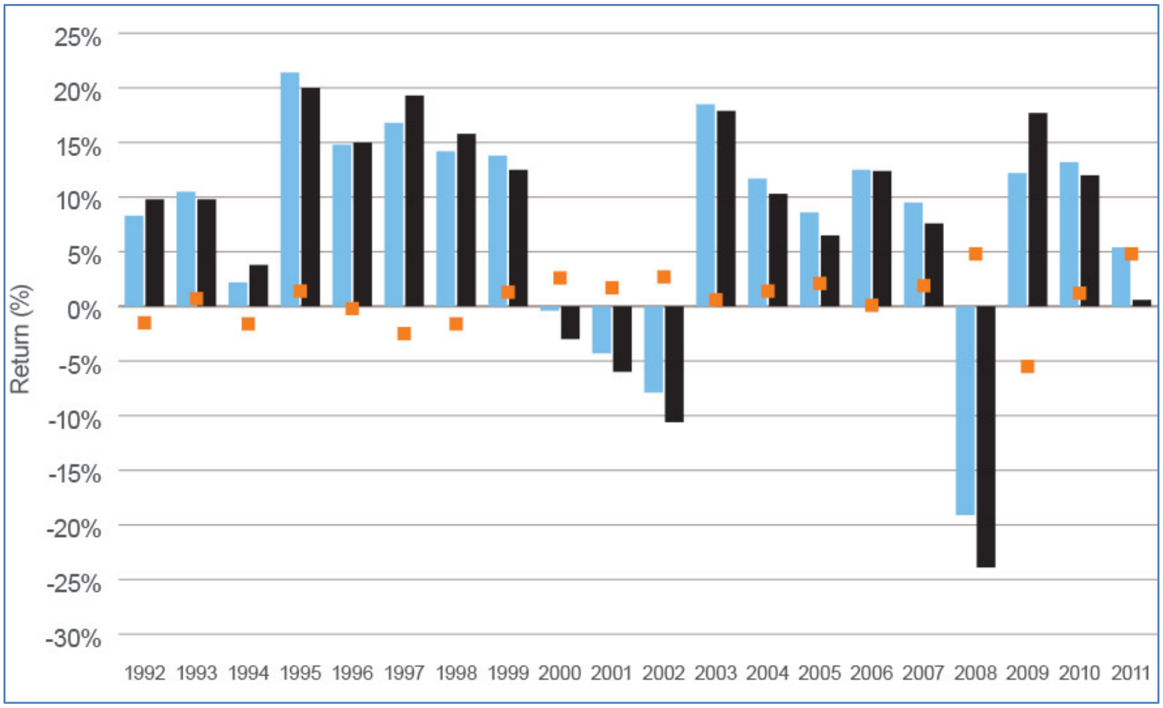
Two of the largest barriers for employers and plans sponsors to add retirement income solutions are administrative complexity and fiduciary concerns. The features of the retirement income generators will vary depending on risk tolerance, economic optimism/pessimism, life expectancy and self-discipline with spending. The report provides plan sponsors with an outline so that they can design a retirement income program and a checklist of questions to ask retirement income providers. It also includes information on administrative and design considerations, issues with offering default retirement income solutions and discussion points on fiduciary liabilities from prominent Employee Retirement Income Security Act (ERISA) attorneys.

PR Newswire
September 25, 2013 Wednesday 6:00 AM EST

Can defined contribution plan returns match defined benefit?

There’s more money in corporate defined contribution (DC) plans than there is in corporate defined benefit (DB) plans today[1], and the gap is only going to get bigger from here. Trouble is: the DC money doesn’t seem to be able to earn the same level of investment returns as DB money does.

The chart below is based on the more-than-80,000[2] form 5500s that are gathered each year by the Department of Labor, as summarized in the latest release of their private pension plan bulletin (which runs through the end of 2011). The chart shows the aggregate rate of return earned over the twenty years 1992-2011. DB (in blue) beat DC (in black) in 14 out of 20 years, including 12 of the last 13. A dollar invested on January 1, 1992 and earning DB rates of return would twenty years later have been worth $4.36; earning DC rates of return, just $3.70. That's quite a shortfall.



Can DC plan returns match DB?

Source: Department of Labor, Russell Investments.

And it's not because DB plans were following a riskier investment strategy: DC asset allocations were in aggregate more aggressive and returns were more volatile than DB, and some of the biggest DC underperformance came in the years in which markets fell. In an earlier study, researchers at Boston College found three main causes of the difference in returns: asset allocation, fees, and investment habits. Asset allocation tended to enhance DC returns on average (mainly because of the more aggressive allocation); fees were a material drag on DC; investment habits—notably "poor timing and other investment mistakes"[3]—were another big negative.

That and other similar studies were one of the reasons the DC system has re-aligned itself from a do-it-yourself system relying on participant education and retail mutual funds into a default-based system built on nudging and decision architecture.

It's difficult to extract the data to confirm whether those changes are having the desired effect: Qualified Default Investment Alternatives (QDIAs)—the investment vehicles at the heart of the new system—still represent a small, albeit growing, percentage of total DC assets. The most popular QDIA option is a Target Date Fund (TDF); these tend to have a higher allocation to equities than either the DB or DC system as a whole, reflecting the age profile of the investors in those funds and the sizeable allocation to stable value funds among non-QDIA DC assets. The data that is available seems to point to aggregate TDF performance being more volatile than DC plans in general (doing better in strong markets, worse in weak), almost certainly a result of that higher equity allocation. So performance comparisons are not necessarily comparing like to like.

But we know enough about current practices to know the main weaknesses are being addressed: we know the level of attention paid to fees is much greater than it was in the past; we know QDIAs follow disciplined asset allocation strategies, not chasing recent performance.

It is not a new idea that "Policymakers will not accept going from an efficient system to an inefficient one,"[4] but there are signs that the steps taken to date are moving us in the right direction.

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[1]According to the Federal Reserve's latest Flow of Funds report, there is $2.6 trillion in private DB plans and $4.3 trillion in private DC.

[2]The data shown is for plans with more than 100 participants. There were a further 600,000 or so pension plans—mainly DC—with fewer than 100 participants, whose results were not included here.

[3]Munnell, Soto, Libby and Prinzivalli (2006). Investment returns: defined benefit vs. 401(k) plans. Center for Retirement Research at Boston College, Issue Brief #52.

[4]Michael Barry of Plan Advisory Services, quoted in Ezra, Collie, Smith (2009) The Retirement Plan Solution John Wiley and Sons, p12.

September 16, 2013 Bob Collie Categories: