BCG Retirement News Roundup

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

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

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

BCG Retirement News Roundup 2015

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Puerto Rico's Bonds Overshadow Pension Fund Poised to Go Broke

Puerto Rico's $72 billion debt burden overshadows another financial threat to the Caribbean island: a government workers pension fund that's set to go broke in five years.

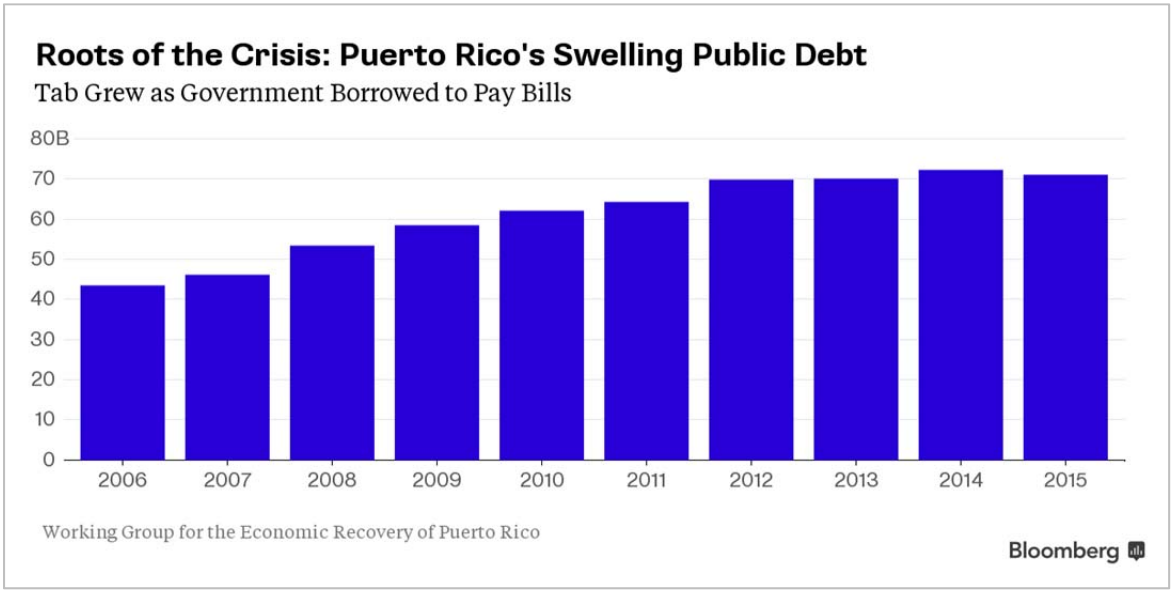
As Governor Alejandro Garcia Padilla prepares to push for bondholders to renegotiate debts he says the commonwealth can't afford, he's also contending with an estimated $30 billion shortfall in the Employees Retirement System. The pension, which covers 119,975 employees, as of June 2014 had just 0.7 percent of the assets needed to pay all the benefits that had been promised, a level unheard of among U.S. states.

If not fixed, the depleted fund could jeopardize a fiscal recovery by foisting soaring bills onto the cash-strapped government even if investors agree to reduce the island's debt. The system is poised to run out of money by 2020, which would leave the government on the hook for more than $2 billion in benefit payments the next year alone, according to Moody's Investor's Service. That's equal to about one-fourth of this year's general-fund revenue.

"As Puerto Rico shoulders that burden of paying for pension benefits outright, that's obviously going to cripple their budget," said Ted Hampton, a Moody's analyst in New York.

Crisis Builds

The debt crisis gripping the island, with a population of 3.5 million, is the outcome of years of borrowing to pay bills while the economy stumbled and residents left for the U.S. mainland. In August, Puerto Rico defaulted on some bonds for the first time, and Garcia Padilla has said that reducing its debt is crucial to the island's economic recovery.



His administration and outside advisers on Sept. 9 released a plan to repair the island's finances, which included closing schools and reducing benefits to the poor. It also envisions making increased pension payments that have been delayed because the government hasn't had the money.

"We believe this plan addresses the system's needs and assures pensioners and participants that their benefits will be paid," Pedro Ortiz Cortes, administrator for the retirement system, said in an e-mail Thursday.

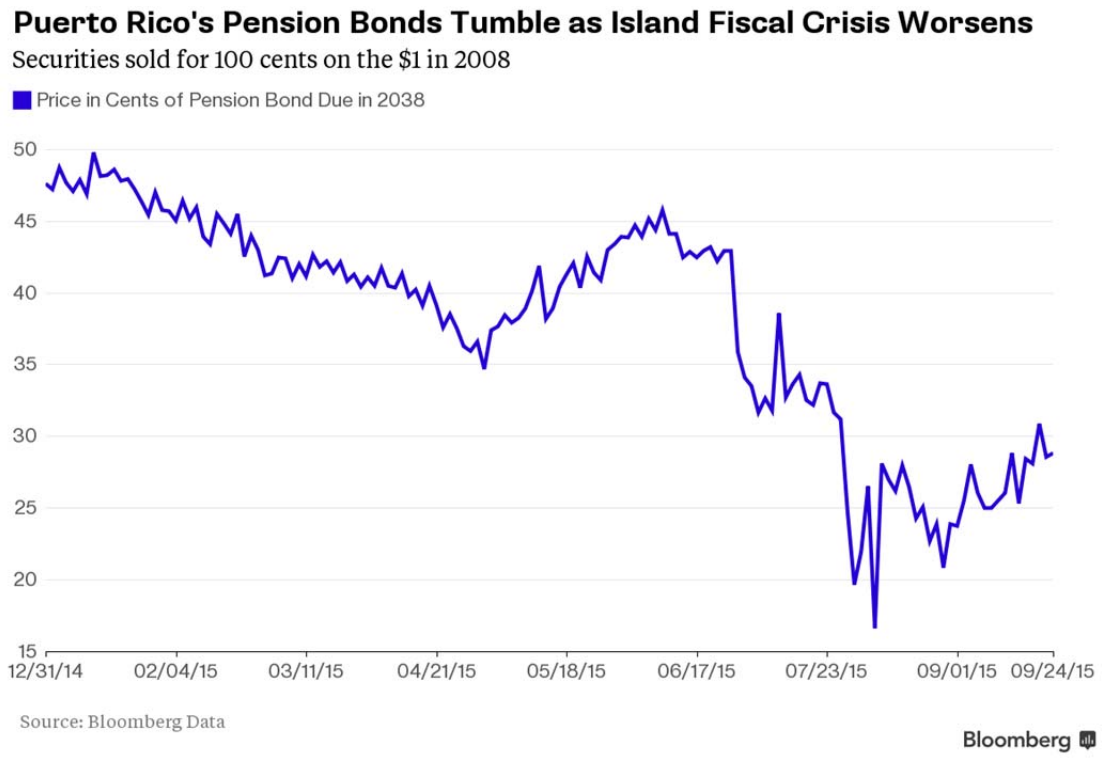
Workers' Doubts

Puerto Rico's failure so far to address its long-building pension shortfall has fostered anxiety among workers, who are concerned that their benefits will be reduced amid competing demands from creditors. "A reduction in benefits would be horrible," said Eduard Rodriguez Santiago, a 38-year old firefighter. "Things are getting more expensive."

Garcia Padilla, in a speech after the release of the fiscal plan, said that workers have already sacrificed enough. In 2013, the government raised the retirement age, increased employee contributions and reduced or eliminated retiree bonuses.

"Solving the pension problem is almost tougher than debt because people will take to the streets if you start seeing pension checks quit going out," said Tom Schuette, co-head of credit research at Solana Beach, California-based Gurtin Fixed Income Management LLC, which manages $9.6 billion of municipal securities. "It's almost much easier to anger investors on the mainland as opposed to residents who can vote you out of office."

Current and prior administrations have implemented changes to improve the pension system, including by closing it to new employees and offering them annuities instead. To give it cash to invest, it sold $2.9 billion of bonds in 2008, just before the credit crisis caused stock prices to plunge. The system is now obligated to repay the securities, which have tumbled in value amid doubts about its ability to do so.



Prices on pension bonds

As Puerto Rico has cut the number of workers on its payrolls, there are fewer paying into the retirement system. The island had 116,000 central-government employees in May 2015, down 27 percent from seven years earlier, according to the report by the government and its advisers.

While new employees haven't been eligible for traditional fixed-benefit pensions since 2000, the step didn't stop Puerto Rico's growing liabilities. The new employees, called System 2000 participants, will receive an annuity instead. Their contributions are being used by the pension system to meet its obligations.

New Liabilities

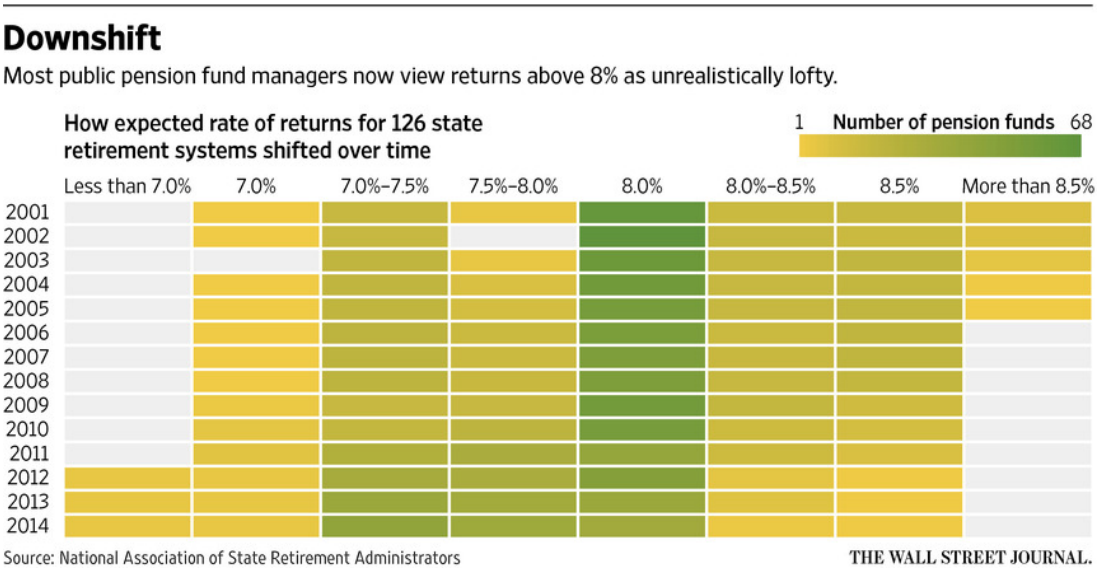
"They're using these payments to shore up their existing defined-benefit plan," said Hampton, the Moody's analyst. "Their defined-contribution plan isn't really taking hold. It's just creating new liabilities for the central government."

Puerto Rico is facing more immediate concerns because it may be short of cash as soon as November. That may leave it forced to choose between paying workers and retirees or bondholders, with $357 million of interest on its general obligations due Jan. 1.

"If the government has to decide between making a big general-obligation payment in January or making sure they have enough for payroll or for pensioners in December, I think they're going to go with the pensioners or payroll," Sergio Marxuach, public-policy director at the Center for a New Economy, a research group in San Juan. "You're not going to send government workers home without money during Christmastime."

Public Pension Funds Roll Back Return Targets

Few managers count on returns of 8%-plus a year anymore; governments scramble to make up funding.



Public pension funds from California to New York are cutting investment-return predictions to their lowest levels since the 1980s, a shift that portends greater hardships for employees and cash-strapped governments as Americans age.

New upheavals in global markets and a sustained period of low interest rates are forcing officials who manage retirements for nearly 20 million U.S. beneficiaries to abandon a long-held belief that stocks, bonds and other holdings would earn 8% each year, as well as expectations that those gains would fund hundreds of billions of dollars in liabilities.

More than two-thirds of state retirement systems have trimmed assumptions since 2008 as the financial crisis and an uneven U.S. recovery knocked many below their long-term goals, according to an analysis of 126 plans provided by the National Association of State Retirement Administrators. The average target of 7.68% is the lowest since at least 1989. The peak was 8.1% in 2001.

On Friday, the New York State Common Retirement Fund, the third-largest public pension by assets, said it plans to drop its assumed returns to 7% from 7.5% after cutting a half-percentage point five years ago. That followed Thursday's vote by the San Diego County Employees Retirement Association to drop its level to 7.5% from 7.75%.

"Realism," said Brian McDonnell, managing director for pension consultant Cambridge Associates, is "creeping in."

Moving expectations below 8% isn't just an arcane accounting move. It has real-life consequences for systems that use these predictions to calculate the present value of obligations owed to retirees. Even slight cutbacks in return targets often mean budget-strained governments or workers are asked to pay significantly more to account for liabilities that are expected to rise as lifespans increase and more Americans retire. A drop of one percentage point will typically boost pension liabilities by 12%, said Jean-Pierre Aubry, an assistant director at the Center for Retirement Research at Boston College.

Public pension funds use a combination of investment income and contributions from employees, states and cities to fund benefits.

In Boulder, Colo., the city eliminated 100 positions and consolidated city programs as a way of compensating for three reductions in the state's investment forecast and a rise in pension contributions, as the economy sputtered. It also stopped planting tulips in most areas and shifted to less expensive wildflowers as a way of making an additional $1.7 million in pension payments, according to the city's chief financial officer, Bob Eichem. "You do more with less," Mr. Eichem said.

U.S. pensions first started to reconsider their investment-return assumptions after being stung by deep losses during the 2008 financial crisis. The event helped drop 10- and 15-year annual returns at large public pensions to 6.9% and 5.8%, respectively, according to the Wilshire Trust Universe Comparison Service. The retirement systems' median return was 3.4% for the 12 months ended June 30 amid downturns in foreign stocks and bonds, their worst annual performance since 2012.

Retirement systems argue that lowering assumptions fortifies their fiscal health, because the influx of extra contributions means they become less reliant on generating big returns.

Some big funds are preparing to pull their goals back even further. The California Public Employees' Retirement System, the nation's largest pension, is discussing a new reduction below its level of 7.5%. The Oregon Public Employees Retirement System and the Texas Municipal Retirement System, the 14th and 35th largest, both approved lowering their forecasts in late July by a quarter of a percentage point. "Those days" of believing 8% could be earned annually "aren't here anymore," said New York state Comptroller Thomas P. DiNapoli.

But some critics contend that pensions are still relying on unrealistic expectations to fill ballooning funding gaps even as they move targets below 8%. The lower assumptions remain considerably higher than levels seen in the 1960s, when pensions estimated 3% to 3.5% returns from portfolios primarily comprised of cash and bonds. Pension officials pushed their predictions higher in subsequent decades as they embraced riskier holdings of stocks, real estate, commodities and hedge-fund assets.

"It's clearly not enough," said Josh McGee, a senior vice president of public accountability at the Laura and John Arnold Foundation, a nonprofit that has worked across the U.S. for changes to guaranteed pension benefits.

Pension funds said that while performance has lagged behind of late, they generally have been able to hit their targets over longer periods and expect to continue to do so.

A panel of U.S. actuaries and pension specialists has recommended that public systems move their assumed future returns down to 6.4%, and many corporations already use a more conservative rate for their pension funds. The average for companies listed in the Fortune 1000 dropped to 7.1% in 2014 from a high of 9.2% in 2000, according to a Towers Watson survey.

The most aggressive move downward among public employee pensions belongs to Delaware, where the state retirement system has dropped to a target of 7.2% from 8.5% in 2003, the largest change since 2001 among state plans tracked by the National Association of State Retirement Administrators. David Craik, the retirement system's pension administrator, said he wouldn't rule out further decreases.

"I'm kind of surprised others aren't going as low as we did," Mr. Craik said.

More big pullbacks by public plans would likely create deeper financial pain for governments and employees that have already cut services and benefits. Local and state contributions to retirement systems have more than doubled over the past decade, to $121.1 billion in 2014, according to the U.S. Census Bureau. During that same time worker pension contributions rose 50%, to $45.5 billion.

In Fullerton, Calif., officials are sharing a fire chief and command-level staff with one neighboring town and splitting up tree-cutting contracts with other cities in the wake of a half-percentage point cut in return assumptions for the state's retirement system. It was able to save $1.2 million.

"The pension costs are high and will continue to be high," said Joe Felz, Fullerton's city manager. "It's tops to bottom looking where we can get savings."

Still, some retirement systems believe 8% is possible, as 39 of them maintain forecasts at or above that old industry mark, according to the National Association of State Retirement Administrators. Two of them—the Houston Firefighters' Relief and Retirement Fund and the Connecticut Teachers' Retirement System—assume returns of 8.5%, the highest of any other plans.

"We strongly believe, and past history shows, we can continue to achieve the 8.5% long term," said Todd Clark, chairman of the Houston firefighters' fund. The Connecticut fund didn't respond to requests for comment.

U.S. Supreme Court asked to weigh in on N.J. public pension fight

The New Jersey state troopers unions that first launched the legal fight over Gov. Chris Christie's broken pledge to raise payments into the public worker pension system is asking the U.S. Supreme Court to overturn a state court ruling that sided with the governor, the unions' attorney said Friday.

The three labor unions representing troopers and officers want the nation's highest court to reverse a state Supreme Court ruling that struck down a portion of a 2011 pension reform law forcing the state to put billions of dollars into the public pension system.

The petition requesting the U.S. Supreme Court to consider the case asks it to apply federal contract protections to an agreement between the state and public employees that the state Supreme Court declared "unenforceable" in June.

"There are over 2,500 New Jersey State Troopers in the state administered pension system who are dependent upon certiorari to protect the future of their retirement," according to the petition.

In fact, the pension system supports the retirement of some 800,000 people, working and retired.

The state troopers unions, which were later joined by about a dozen more groups, sued the governor last summer for slashing $1.57 billion from the pension payment for the previous fiscal year that ended in June.

They said Christie had breached their constitutionally protection contractual right to pension funding under that 2011 law. The law ostensibly created a contract between the state, which would increase pension payments, and workers, who would also contribute more from their paychecks toward their benefits.

In June, the New Jersey Supreme Court, voting 5-2, overturned a lower court ruling and decided that the contract violated certain state constitutional principles, including one that the Legislature cannot create large debts without the voters' consent and another that bars lawmakers for binding the hands of future Legislatures.

Christie was spared from finding billions of dollars for future pension payments in future budgets, while employees must continue to pay higher rates.

"The state has found a way to avoid its contractual obligation in violation of the constitutional rights of the hundreds of thousands of retired and present public workers throughout the state of New Jersey who are still being required to perform under this alleged 'unenforceable contract'," the unions' attorneys wrote.

As a result, they said, the state has contributed far less than intended and the system is headed toward insolvency.

In a dissenting opinion, Justice Barry Albin, joined by Chief Justice Stuart Rabner, offered a potential road map for the unions to seek U.S. Supreme Court review, saying the state court's finding flew in the face of the federal Constitution's Contract Clause. That clause bars states from passing any law that interferes with a contractual agreement.

"Clearly, the state's payment of less than 30 percent of its annual required pension contribution for fiscal year 2015 constituted a substantial impairment of contractual rights of public employees in violation of the Federal Contracts Clause," Albin wrote.

He added, "The majority's novel and strained interpretation of our state Constitution cannot defeat the federal rights of public workers in this case."

In the petition, the unions argue that annual pension contributions are not "debt or borrowed money," but an ordinary government expense or payment for services rendered. The New Jersey Supreme Court ignored precedents and misapplied the Debt Limitation Clause, the petition said.

The odds the court will grant the petition are not in the unions' favor. The U.S. Supreme Court accepts fewer than 1 percent of the 10,000 cases it's asked to hear each year.

At issue, according to the writ, is whether the state court erred by declaring the contract in conflict with the state appropriations clause and by failing to perform a federal contracts clause analysis.

"The contract clause of the Federal Constitution forbids the state from doing exactly what occurred here. The state cannot enter into a public contract for its own benefit, and then legislatively impair that contract when abiding by the contract no longer suits it."

Invoking Albin's language in the dissent, it adds "The U.S. Constitution bars a state from destroying a contract of its own making."

Spokesmen for Christie and the Attorney General's Office declined to comment.

Senate President Stephen Sweeney (D-Gloucester) spokesman Luke Margolis said Sweeney hasn't reviewed the brief yet, but that "he has never wavered from what he believes to be the only legal interpretation of the law... the pension should be fully funded."

Median U.S. Public Pension Funding on the Rise: Report

In 2014, the majority of states (33) saw their pension funding levels rise – and median funding levels for all 50 states is on an upward trajectory, according to a report provided to Pension360 by Loop Capital Markets.

On the other end of the spectrum, 16 states saw their funding levels decline, with Michigan seeing the largest drop.

The key findings, summarized by Ai-Cio:

The median funded level for the 50 states and District of Columbia grew to 71.5%, up from 69% in 2013. The mean funded level in 2014 was 73.1%, compared with 71.9% the year prior.

Despite the increases, only Washington, DC, South Dakota, and Wisconsin were found to be fully funded, with five states recording funded levels above 90%. A total of 18 states had funded levels greater than or equal to 80%, an increase from 14 in 2013.

However, while a total of 33 states increased funding in 2014, 16 states continued to fall further into pension debt. These states declined enough to bring the overall national funded level down from 73.1% in 2013 to 72.6%.

Worst off is Illinois, which remained stable over the year at 39% funded.

Over five years, 30 states have lower funded levels, with Michigan declining the most from 79% in 2010 to 61% in 2014. Funding for Kentucky, New York, and Pennsylvania dipped 14% over the same time period.

Meanwhile, Maine and Oklahoma had the largest five-year gains, with each seeing their funded level increase by 15%.

The report analyzed the funding data of 247 state-level plans and 141 municipal plans.

Pennsylvania governor proposes new retirement system compromise

Pennsylvania Gov. Tom Wolf has proposed a new pension system for future state and public school employees as a means to end the state's current budget impasse, said Jeffrey Sheridan, spokesman for the governor's office.

The proposed plan includes a mandatory, 401(k)-style plan for all new employees making at least $75,000 annual income. In addition, all employees could be given the option to participate only in a defined contribution plan at their time of hire. The plan also features a risk-sharing component for all new employees. Mr. Wolf anticipates this proposed plan would reduce Wall Street management fees within the state's two largest retirement systems by a combined $200 million annually. The total savings to the state are an estimated $20.2 billion. Further details could not be learned by press time.

The $51.7 billion Pennsylvania Public School Employees' Retirement System and $27.6 billion Pennsylvania State Employees' Retirement System, both based in Harrisburg, together have an unfunded liability of $60.1 billion.

In July, Mr. Wolf vetoed a pension reform bill that would have enrolled all new state and public school employees in a mandatory defined contribution plan, as well as offering an optional cash balance plan.

Mr. Wolf said in a news release at the time that the legislation he originally vetoed “provides no immediate cost savings to taxpayers and does not maximize long-term savings for taxpayers.”

He added the bill also didn’t address “the over $700 million in fees paid annually to Wall Street firms” to manage the state's investments.

The governor’s office is continuing negotiations with state congressional Republicans to reach an agreement on a final budget.

Private Sector

Final Minimum Funding Rules Feature Few Changes

Newly issued final regulations detailing how to determine minimum required contributions for single-employer defined benefit plans don't look that different from the proposed rules that were issued back in 2008, practitioners told Bloomberg BNA.

“It seems like they made few, if any, changes,” Judy A. Miller, director of retirement policy for the American Retirement Association, said Sept. 9.

On Sept. 8, the Internal Revenue Service and Treasury Department issued final rules on the determination of minimum required contributions for single-employer defined benefit plans. The final rules (T.D. 9732, RIN 1545-BH71) also address the excise tax under tax code Section 4971 for failing to satisfy the minimum funding requirements for defined benefit plans.

Heidi Rackley, a partner with Mercer LLC, said Sept. 9 that the rules weren't particularly controversial and most of the changes featured in the final rules are minor corrections or clarifications.

But there is one change that will make plan sponsors happy, she said.

“From my perspective, the biggest change is the new ability to make standing elections to apply credit balance toward quarterly contributions, and that really just cuts down a lot of paperwork that goes on between the actuary, the plan administrator and the plan sponsor,” Rackley said.

Under the proposed rules, employers that were subject to the quarterly contribution requirements and were using credit balances had to make an election of a specific dollar amount each quarter, which isn't really a “huge deal” except when someone misses a contribution, she said.

The final rules allow plan sponsors to elect a formula instead of a dollar amount, which allows much more flexibility and certainty, Kathryn L. Ricard, senior vice president for retirement policy with the ERISA Industry Committee, said Sept. 9.

Rackley added that the ramifications of missing a quarterly payment were bad, and it was actually fairly easy to do, so the change in the final rules is a welcome one.

Another change Ricard highlighted was that the IRS reserved a section for the definition of plan spinoffs and mergers. This can be a very uncertain area for sponsors, particularly for large employers, so the message there is “stay tuned,” she said.

Maryland establishes commission to study expanding private-sector retirement savings

Maryland is launching a commission to consider ways to expand workplace access to private-sector retirement savings, political leaders in Annapolis announced Tuesday.

Legislative and private-sector representatives serving on the commission will build on work done in 2014 by a governor's task force on retirement security, which found that more than 1 million state residents lacked access to retirement savings at work, and recommended that state officials create a payroll deduction retirement program.

The newly formed Commission on Maryland Retirement Security and Savings will be co-chaired by Maryland state Sen. Douglas Peters and state Delegate William Frick. Other commission members include Nancy Kopp, state treasurer; Sarah Gill, AARP senior legislative representative; Joshua Gotbaum, Brookings Institution scholar; Gary Kleinschmidt, Legg Mason (LM) retirement sales director; and Kathleen Kennedy Townsend, who chaired the governor's task force and is a former lieutenant governor and founder of the Center for Retirement Initiatives at the McCourt School of Public Policy at Georgetown University.

Maryland House Speaker Michael Busch, who launched the effort with Senate President Thomas Miller Jr., said in a statement that the risk of retirees outliving their savings and relying more on government programs “is becoming all too familiar.“ The commission will issue a report in December.

“AARP is delighted that Speaker Busch and President Miller are pulling together a group of thought leaders from across Maryland and around the country to address solutions to financial insecurity in retirement,” Ms. Gill said in an e-mail. “Knowing that workers are 15 times more likely to save if they have access to payroll deduction, we anticipate that ensuring access to a way to save for retirement at work will be a top priority of the group.”

PBGC REPORTABLE EVENTS RULE FOCUSES ON PLANS MOST AT RISK

The Pension Benefit Guaranty Corporation issued a final rule on pension plans' requirements to report various corporate and plan events to the agency that the PBGC says focuses on identifying the minority of defined benefit plans and their sponsors that pose the greatest risk of defaulting on their financial obligations.

The new regulations (RIN 1212-AB06) provide most plan sponsors with increased flexibility to determine whether a waiver from reporting requirements will apply, the PBGC said Sept. 10 in announcing the issuance of the rule.

The new rule will help the agency get the information it needs and "will reduce the burden for employers whose pension plans are not at risk," Alice Maroni, the PBGC's acting director, said in a news release. It will give "companies flexibility to use information they have readily at hand to see if they are eligible for a waiver and need not report to" the PBGC, she said.

The rule will change existing regulations and guidance for pension plans and their sponsors on requirements they face on the reporting to the PBGC of various corporate events, such as loan defaults and controlled group changes, and plan events, such as big drops in the number of active plan participants, missed plan contributions or insufficient funds. The reporting is designed to give the agency a heads-up on events that may indicate the plan or the sponsor is having financial difficulties so the agency can determine if it needs to take action to ensure plan participants continue to receive their benefits.

The final rule, slated for publication in the Federal Register on Sept. 11, finalizes the agency's 2013 proposed rule on reportable events, and will apply to events that occur after Jan. 1, 2016.

'Seat at the Table.'

Harold J. Ashner, a partner with Keightley & Ashner LLP, said that with the rule, the "PBGC is clearly trying to get a 'seat at the table' well in advance of a possible bankruptcy."

For example, he said the new definition under the final rule of a loan default reportable event, unlike the old definition, captures situations in which there isn't any "loan default as a result of the lender having waived or agreed to an amendment of a loan agreement provision."

Ashner, who formerly served as the PBGC's assistant general counsel for legislation and regulations, said that because many corporate loan and other agreements include provisions tied to the PBGC's reportable events regulations, practitioners will need to review these significant regulatory changes very carefully to determine how they may affect existing and future agreements. Though the new rules don't go into effect until 2016, they may impact agreements entered into before 2016, depending on how those agreements were or will be drafted, Ashner said.

Representatives of the ERISA Industry Committee and the American Benefits Council said they were concerned about the final rule's continuation of the proposed rules' scheme of connecting reportable events to plan sponsors' financial statements and metrics rather then to the funding of the plans themselves.

IRS Takes First Steps Towards Revamping Qualified Plan Determination Letters

Employee Benefits & Executive Compensation

Action Item: The IRS has taken the first steps towards what is likely to be the end of the determination letter program for individually designed qualified plans. The determination letter has been the cornerstone of compliance for more than 30 years. The end of the program will have a significant effect on how employers keep plans qualified and represent that they are qualified to third parties.

The Internal Revenue Service has announced a significant curtailment of the determination letter program for individually designed qualified retirement plans. We suspect it is the first step towards the eventual virtual elimination of the program.

The IRS's action:

Effective 2017, eliminates the five-year staggered submission process for individually designed plans.

Effective immediately, eliminates "off-cycle" submissions of individually designed plans.

Prospectively, curtails the determination letter program for individually designed plans to new plans and plan terminations (and certain special circumstances to be identified by the IRS in the future).

This effectively means that some individually designed plans will have already received the last determination letter until plan termination, and the remaining individually designed plans will receive that last letter over the next few years.
Background

For more than 30 years, the Internal Revenue Service has permitted employers and others who write and market plan documents to submit such documents for IRS review and approval. The IRS's program has historically been divided into two parts:

1. Employers may seek the IRS's determination that the employer's plans are qualified in form. These plans are typically referred to as "individually designed" plans and the IRS's rulings approving them are referred to as "determination letters." The determination letter is issued to the employer.

2. Mutual fund companies, banks, trust companies, attorneys, etc., that use "off the shelf" documents for their clients and customers may seek the IRS's review of such documents. These documents are typically referred to as "prototype" or "volume submitter," and the IRS's rulings

approving them are referred to as advisory letters or opinion letters. In some cases, adopting employers of these types of documents may make changes to the plan document or select from among options within the plan document. Frequently, adopting employers of volume submitter documents will seek a determination letter for the plan as adopted.

The determination letter, advisory letter, and opinion letters have been the cornerstone of qualified plan compliance. There are literally hundreds of legal requirements that must be reflected in a qualified plan document. The letter gives the IRS's imprimatur that the plan meets those requirements. If a plan has a timely letter and is operated pursuant to the plan's terms, the IRS will never challenge the qualified status of the plan. As a result, accounting firms request the letter as part of the annual audit; record-keepers and investment managers request the letter before they will provide services in connection with the plan; sellers in corporate transactions must produce the letter as part of the due diligence process and must represent that the letter is currently effective; and the IRS's guidance for correcting operational issues is conditioned on the plan's having received a favorable determination letter. Although a determination letter is not a requirement for qualification, it has clearly been best practice to obtain one.

The laws regarding qualified plans frequently change, and such changes must be reflected in the plan document. Accordingly, the IRS letters have a limited shelf life, i.e., the period during which the employer and others may "rely" on the letter ultimately expires. Under the current procedures, the sponsors of prototype and volume submitter documents must submit the documents for IRS review every six years. The last round of submissions for all such documents was February 1, 2011, through April 2, 2012. All letters for prototype and volume submitter documents were issued on March 31, 2014, and employers who use these types of documents have to adopt the newly approved restated plans by April 30, 2016.

Until the IRS's recent announcement, sponsors of individually designed plans had to submit their plans for a new determination letter every five years according a staggered schedule:

Cycle	Last Digit of Employer EIN	Period for Next Filing
E	5 or 0	2/1/2015-1/31/2016
A	1 or 6	2/1/2016-1/31/2017
B	2 or 7	2/1/2017-1/31/2018
C	3 or 8	2/1/2018-1/31/2019
D	4 or 9	2/1/2019-1/31/2020

Effects of IRS Action

The IRS's action has the following practical effects:

Any individually designed plan for which an employer has applied for a determination letter and is currently under IRS review will continue to be reviewed by the IRS.

Cycle E plans may and should be filed before January 31, 2017.

Cycle A Plans may and should be filed between February 1, 2016, and January 31, 2017.

Employers should consider filing for determination letters upon plan termination. We do not recommend a filing in all cases.

Effective 2017, individually designed new plans, regardless of the employer's EIN, may and should be filed as soon as possible after adoption. A new plan is defined as a plan that has never been filed for a determination letter, or for which a determination letter has never been issued.

Cycle B, C, and D plans that have received or been submitted for a determination letter may not again request a determination letter until plan termination (subject to certain special circumstances not yet identified by the IRS).

Regardless of whether a plan is eligible for review, employers must continue to update plans to reflect new legislation and guidance, typically by the end of the year in which such legislation or guidance becomes effective. IRS model language will be more important. For discretionary amendments that are not driven by changes of legal requirements, the best practice is to amend the plan before the amendment's effective date. The IRS is exploring other timetables to keep documents compliant.

Adopters of pre-approved volume submitter plans may submit plans for review on or before April 30, 2016, regardless of the employer's EIN.

Our expectation is that the program for pre-approved plans will remain viable, and indeed employers with individually designed plans may want to consider transitioning to a pre-approved plan in order to maintain reliance on the IRS's letter.

Observations

The IRS is accepting and reviewing comments on the new guidance, and we expect that there will be some significant changes. In its present form, the guidance could result in many individually designed plans being re-stated on pre-approved prototype and volume submitter

documents, which will be an expensive and time-consuming process. However, the following would be good current practice as this guidance process unfolds:

Work on Cycle E and Cycle A individually designed plan submissions should continue.

Adopters of volume submitter plans should apply for determination letters before the April 2016 deadline.

Any employer that is terminating a plan should consider submitting the plan for a final determination letter.

Every new individually designed plan that is not Cycle B, C, or D should submit for a determination letter after January 2017.

All plans must continue to be amended from time to time consistent with the IRS's annual cumulative list of changes in retirement plan qualification requirements.

Notice: The purpose of this update is to identify select developments that may be of interest to readers. The information contained herein is abridged and summarized from various sources, the accuracy and completeness of which cannot be assured. This update should not be construed as legal advice or opinion, and is not a substitute for the advice of counsel.

DOL Clarifies Fiduciary Duties for Defined Contribution Plan Sponsors Offering Annuity Contracts

The availability of annuity options under defined contribution plans has increased in recent years due to the shift from defined benefit to defined contribution plans. Fiduciaries, however, are often concerned with potential claims and lawsuits that could result from the decision to offer an annuity. Over the past several years, the U.S. Department of Labor (DOL) and Internal Revenue Service (IRS) have issued guidance to address these concerns and assist plan sponsors in satisfying their fiduciary obligations with respect to the selection and monitoring of annuity providers.

On July 13, 2015, the Department of Labor issued Field Assistance Bulletin (FAB) 2015-02, which clarifies and interprets a safe harbor under DOL Regulation Section 2550.404a-4 for fiduciaries when selecting an annuity provider for a defined contribution plan. Under the safe harbor, a fiduciary has an obligation to prudently select an annuity provider and prudently conduct periodic reviews of the annuity provider. FAB 2015-02 clarifies that a fiduciary does not have an

obligation to periodically review an annuity provider after the plan stops offering an annuity distribution option.

Background

Compliance with the safe harbor requirements satisfies a fiduciary's obligation to prudently discharge his or her duties in accordance with Employee Retirement Income Security Act of 1974, as amended (ERISA) Section 404(a)(1)(B). The safe harbor rule is satisfied if the plan's fiduciary:

Engages in an objective, thorough and analytical search for the purpose of identifying and selecting providers from which to purchase annuities. This process must avoid self-dealing, conflicts of interest or other improper influence and should, to the extent possible, involve consideration of competing annuity providers;

Appropriately considers information sufficient to assess the ability of the annuity provider to make all future payments under the annuity contract;

Appropriately considers the cost (including fees and commissions) of the annuity contract in relation to the benefits and administrative services to be provided under such contract;

Appropriately concludes that, at the time of the selection, the annuity provider is financially able to make all future payments under the annuity contract and the cost of the annuity contract is reasonable in relation to the benefits and services to be provided under the contract; and

If necessary, consults with an appropriate expert or experts for purposes of compliance with these provisions.

FAB 2015-02

In General

FAB 2015-02 clarifies a fiduciary's responsibilities under the safe harbor regulations when selecting and monitoring an annuity provider. It provides that a fiduciary's prudent selection and monitoring of an annuity provider is judged based on the information available at the time of selection and at each periodic review, rather than on subsequent events. The fiduciary is also not required to review the appropriateness of its conclusions with respect to an annuity contract purchased for any specific participant or beneficiary.

FAB 2015-02 offers guidelines for satisfying the selection and monitoring requirements under the safe harbor rule:

The periodic review requirement does not mean that a fiduciary must review the prudence of retaining an annuity provider each time a participant or beneficiary elects to receive a distribution in the form of an annuity from the selected annuity provider.

The frequency of periodic reviews depends on the facts and circumstances. For example, a fiduciary may have an obligation to conduct an immediate review if he or she knows that the annuity provider is not making annuity payments or that a major insurance rating service downgraded the annuity provider.

Cessation of Duty to Monitor

FAB 2015-02 also provides the time at which a fiduciary's duty to monitor an annuity provider ends. A fiduciary's monitoring responsibility with respect to a particular annuity provider ends when a plan stops offering annuities from that annuity provider. This could occur if a plan replaces an annuity provider or stops offering an annuity distribution option.

FAB 2015-02 includes two examples for illustrative purposes. In the first example, the plan offers an immediate annuity offered by an annuity provider as a distribution option. The fiduciary's duty to monitor ends when the fiduciary stops offering annuities from the annuity provider. In the second example, the plan includes a qualifying longevity annuity contract as a distribution option. Participants may purchase the annuity by making premium payments. Annuity payments commence at a specified time after a participant retires or when the participant turns 80 or 85. The fiduciary duty to monitor ends when qualified longevity annuities from the annuity provider are no longer offered as distribution options.

Statute of Limitations

FAB 2015-02 clarifies the statute of limitations applicable to a breach of fiduciary duty claim for imprudently selecting or monitoring an annuity provider. An action for a breach of fiduciary duty may not be brought after the earlier of (a) six years after the date of the last action which constituted a part of the violation or, in the case of an omission, the latest date on which the fiduciary could have cured the violation, or (b) three years after the earliest date on which the plaintiff had actual knowledge of the breach. FAB 2015-02 states, for example, that a claim for imprudently selecting an annuity contract would have to be brought within six years of the date on which plan assets were expended to purchase the contract. The statute of limitations does not continue running while a participant receives annuity payments.

Conclusions

The proliferation of annuity distribution options in defined contribution plans and the application of the duty to monitor them are still developing. Plan fiduciaries should be aware of the risks associated with offering an annuity distribution option in a defined contribution plan as well as the safe harbor framework established by the DOL to assist plan sponsors in satisfying their fiduciary obligations in the selection and monitoring of annuity providers.