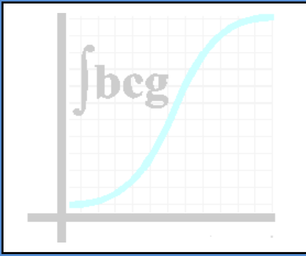

BCG Retirement News Roundup

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Boomershine Consulting Group, 3300 North Ridge Road, Suite 300, Ellicott City, Maryland 21043

www.boomershineconsulting.com **410-418-5525**

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

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

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

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Public Sector/Government Plans

Majority of Public Pension Plans Have Made Recent Reforms

WASHINGTON, DC - 12/28/16 - A new issue brief from the Center for State and Local Government Excellence, "State and Local Pension Reform Since the Financial Crisis" examines how, why, and to what extent state and local governments have enacted pension reforms in the aftermath of the financial crisis.

Authors Jean-Pierre Aubry and Caroline Crawford from the Center for Retirement Research at Boston College examined data from 2009-2014 for all 114 state plans and 46 local plans in the Public Plans Database (http://publicplansdata.org) along with an additional 86 local plans and found that:

The brief's key findings include:

- 74 percent of state plans and 57 percent of large local plans have cut benefits or raised employee contributions to curb rising costs
- Plans with a larger pension cost burden and lower initial employee contributions were more likely to enact such changes.
- States with the strongest legal protections for current workers were more likely to limit the cuts to new hires.
- New employees most commonly experienced increases in the age and tenure required to claim benefits; reductions in the benefit multiplier; and increases in and number of years used to calculate final average salary.
- Higher employee contributions were the most common benefit reduction for current employees followed by reductions to the COLA.

Read the full brief at : http://slge.org/publications/state-and-local-pension-reforms-since-the-financial-crisis

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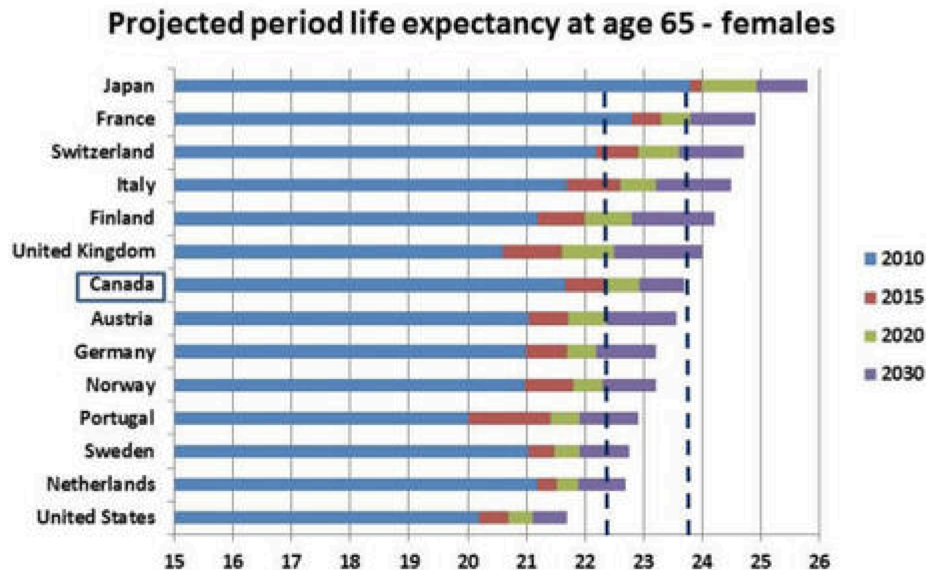
How long do U.S. retirees live compared to peers in other countries?

If you're an American retiree worried about outliving your savings, you may have an (unwanted) edge compared to retirees in other countries: U.S. retirees are expected to live shorter lives on average compared to citizens of most other developed nations. That's according to an analysis presented at the recent Living to 100 Symposium sponsored by the Society of Actuaries (SOA).

How long a country's citizens are expected to live is one very important measure of their quality of life. To begin with, living a longer life is generally considered to be better than living a

shorter one. But there's more to the quality of life than just its length. People who live longer are generally healthier than people who don't, and retirees rank staying healthy as a top factor for happiness.

Unfortunately, the U.S. ranks last or near last--– depending on the group being analyzed -- in one measure of life expectancy presented at the SOA meeting: remaining life expectancy at age 65. The graph below compares women's remaining life expectancy for 14 developed nations including the U.S.:



The blue bar calculates the remaining years of life for a 65 year-old female assuming that death rates in 2010 remain constant in all future years (i.e., no future improvements in mortality). By this measure, a 65-year-old woman in the U.S. can expect to live a little more than 20 years, ranking second to last, ahead of only Portugal.

The red bar reflects life expectancies calculated by assuming projected improvements in mortality through 2015, the green bar represents projected improvements in mortality through 2020 and the purple bar represents projected improvements in mortality through 2030. By all

three of these measures, the U.S ranks dead last.

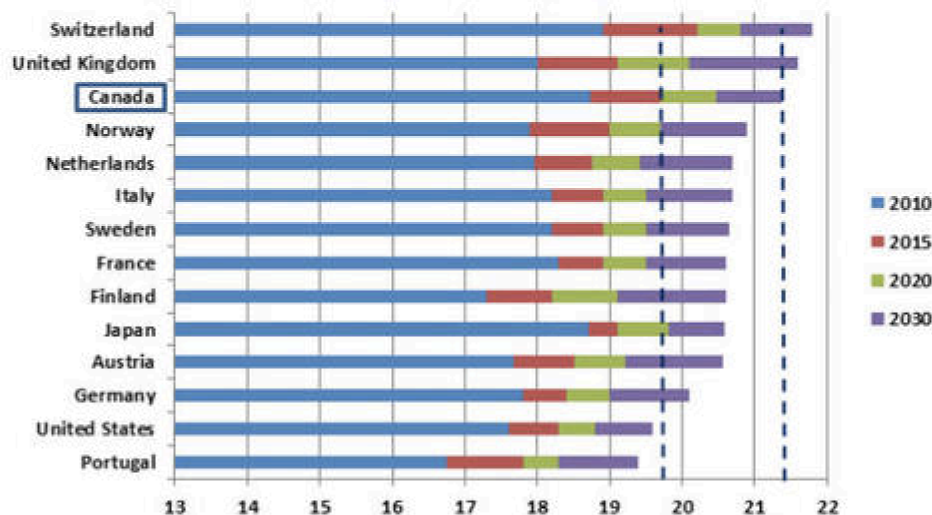
These life expectancies are calculated by the actuaries who assess each country's social security or government pension system. Each actuary may have differing views of optimism regarding future improvements in mortality, which is reflected in the projections for 2015, 2020 and 2030.

Nevertheless, the 2010 life expectancies reflect actual mortality rates in 2010 without incorporating any assumptions for improvement, so it's an appropriate snapshot of life expectancy at that time.

Here's the same chart for remaining life expectancies for 65 year-old men:

International Comparisons - Males

Projected period life expectancy at age 65 - males



Source: 18th International Conference of Social Security Actuaries and Statisticians presentations and reports. Data for Canada are produced by the Office of the Chief Actuary, based on CPP27th preliminary assumptions. Data for Japan are from National Institute of Population and Social Security Research (Sept. 2013).

Office of the Chief Actuary **Bureau de l'actuaire en chef**

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Looking at the blue bar, the remaining life expectancy of a 65-year-old man in the U.S. in 2010 is a little more than 17-1/2 years, ranking third to last, ahead of just Finland and Portugal. The U.S. has the same ranking for the 2015 life expectancies, then falls to second to last for the 2020 and 2030. In this case, Finland overtakes the U.S. because the actuaries for the Finland retirement system assumed higher improvements in mortality than the actuaries for the U.S retirement system did.

At the Living to 100 Symposium, I asked the actuaries to speculate about the why the U.S. had such a poor showing. Their top three reasons were:
Large income disparities in the U.S.
More generous retirement benefits in the other countries
The prevalence of universal health care in the other countries
Given these reasons, it seems unlikely that the U.S. will catch up to the other developed nations any time soon. By this quality of life measure, the U.S. is truly exceptional -- but not for the right reasons.

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Public Pensions Put the Squeeze on Fees in 2016, Besting Mutual Funds

Public retirement systems are improving cost-efficiency, increasing funding ratios, and fine-tuning benefits to strengthen their capacity to serve retired public servants for years to come, according to a sweeping annual study by the National Conference on Public Employee Retirement Systems.

The study underscores the many ways in which pension trustees, managers, and administrators are working to ensure funds' fiscal and operational integrity, according to Hank H. Kim, executive director and chief counsel of NCPERS.

"Public pension funds have proved themselves to be durable, reliable investments for more than a century, but they are not resting on their laurels," Kim said. "Their commitment to constant improvement is securing an even brighter future for the millions of public servants who participate in pension plans."

The 2016 NCPERS Public Retirement Systems Study draws on responses from 159 state, local and provincial government pension funds with more than 10 million active and retired memberships and assets exceeding $1.5 trillion. The majority – 77 percent – were local pension funds, while 23 percent were state pension funds. NCPERS conducted the sixth annual study in September, October, and November 2016 in partnership with Cobalt Community Research. Among the key findings:

During 2016, pension funds squeezed down the cost of administering funds and paying investment managers to 56 basis points, or 56 cents per $100 invested, versus 60 basis points in 2015. This is well below the average fee of 68 basis points for stock mutual funds and 77 basis points average for hybrid mutual funds, which include stocks and bonds. "By controlling fees, pension funds continue to demonstrate that they can provide a higher level of benefits to members than most mutual funds do," Kim said.

Average funding levels – the value of the assets in the pension plan divided by an actuarial measure of the pension obligation --climbed for the third year in a row. Funding levels reached 76.2 percent in 2016, up from 74.1 percent in 2015 and 71.5 percent in 2014.

Even as interest rates began to climb, funds continued to tighten assumptions. Almost 40 percent of responding funds said they have reduced their actuarial assumed rate of return, and nearly 30 percent more said they are considering doing so in the future.

Funds also continued to put pressure on benefits. More than 30 percent of respondents said they have increased employee contributions and raised benefit age or service requirements. Funds experienced healthy three-year, five-year and 20-year returns during 2016, close to or exceeding 8 percent. Aggregated 10-year returns came in at 6.2 percent, while one-year returns averaged 1.7 percent. (The one-year figure ticked up to 2.4 percent for plans with fiscal years ending in December.) "All signs point toward continued improvement in increasing public retirement systems' funded status," Kim said.
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SEC Scrutiny Of Public Pension Advisers A Top Priority

The Securities and Exchange Commission recently announced its Office of Compliance Inspections and Examinations' 2017 examination priorities. Public pension advisers will be in the crosshairs, the agency stated. That's great news for public pension stakeholders, such as government workers who depend upon these plans for their retirement security and taxpayers who also contribute to them.

With approximately 450 examiners, accountants and lawyers located throughout 12 SEC offices, OCIE conducts examinations of asset managers to determine their compliance with the federal securities laws. It is responsible for monitoring over 10,000 investment advisers with more than $48 trillion of assets under management.

The results of OCIE's examinations are utilized by the Commission to inform rule-making initiatives, to identify and monitor risks, to improve industry practices and to pursue misconduct.

Regrettably, the SEC examination results are not made available to the public and, as I've written before, the Commission has resisted efforts to make these records available to investors.

I continue to believe that if the SEC were to provide investors with the results of examinations of money managers—examinations which routinely cite compliance violations—public awareness of the risks related to investing with these managers would be radically altered.

Investors would think a lot harder before they handed over their hard-earned savings to so-called investment professionals.

As readers may recall, my firm's three forensic investigations of the $7.5 billion Rhode Island state pension, beginning with a 2013 investigation funded by Council 94 of the American Federation of State, County and Municipal Employees and two more recent investigations crowd-funded by members of the public were all provided to the SEC.

Included in the findings was widespread misrepresentation, lack of disclosure and potential wrongdoing by the pension's investment advisers. We implored the Commission to take a serious look at adviser business practices, as well as the State Treasurer's misrepresentations and complicity in an unprecedented secrecy scheme eviscerating the state's public records laws.

The findings of our 2014 forensic investigation of the $90 billion North Carolina state pension, undertaken on behalf of the State Employees Association of North Carolina were also filed with the SEC.

Most recently, our Jacksonville Police and Fire Pension investigation, commissioned by the Jacksonville City Council, was provided to the SEC.

The SEC seems to be listening to stakeholder concerns that politics, secrecy and skyrocketing fees paid to Wall Street may be inconsistent with prudent pension management.
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Puerto Rico Catholic School Teachers Win Round in Pension Suit

Puerto Rico Catholic school teachers survived a first attempt to dismiss a proposed class action that alleges the administrators of their pension plan mismanaged their retirement assets and failed to comply with ERISA (Martinez-Gonzalez v. Catholic Schs. of the Archdioceses of San Juan Pension Plan , D.P.R., No. 3:16-cv-02077, report and recommendation 1/9/17).

The main issue in the case is whether the Catholic schools' pension plan is subject to the Employee Retirement Income Security Act or exempt from the federal law as a church plan. Pension plans that qualify for ERISA's church-plan exemption don't have to comply with certain obligations, including disclosure and funding requirements under the federal law.

A pension plan established and maintained by a church-affiliated organization—such as the Superintendence of Catholic Schools of the Archdioceses of San Juan—isn't a church plan

exempt from ERISA, Magistrate Judge Bruce J. McGiverin of the U.S. District Court for the District of Puerto Rico said Jan. 9 in refusing to dismiss the case.

McGiverin, in his report and recommendation, relied on three cases by the U.S. court of appeals for the Third, Seventh and Ninth circuits. Those cases, and dozens of others pending in federal courts throughout the U.S., have challenged hospitals that treat their pension plans as church plans. The Puerto Rico lawsuit appears to be the only one that challenges a school system using ERISA's church plan exemption.

The controversy over the use of ERISA's church plan exemption may soon get some resolution. The U.S. Supreme Court will soon be reviewing those three appeals court decisions and deciding whether a pension plan must be both "established and maintained" by a qualifying church-affiliated entity to claim the legal exemption.

Court Likely to Adopt Report

The magistrate judge's opinion was "very thorough and complete," Karen Ferguson, Director of the Pension Rights Center in Washington told Bloomberg BNA. The Pension Rights Center has filed a number of friend-of-the-court briefs supporting participants' positions that their pension plans aren't church plans exempted from ERISA.

The court will, in all likelihood, adopt McGiverin's recommendation, which covered all the bases and adopted all the arguments raised by the participants, attorney Francisco J. Amundaray-Rodríguez, who represents the proposed class told Bloomberg BNA.

"We will file our objections to the U.S. District Judge in charge of the case," attorney Frank Zorrilla, who represents the Superintendence, told Bloomberg BNA via e-mail. We reiterate our position that the pension plan is a church plan by reason of having been "sponsored and established by the church given the fact that the Superintendence" is an "integral part of the church," Zorrilla said.

No Church Plan Exemption

The Superintendence established the plan in 1979 as an ERISA-covered pension plan for employees of Catholic schools in Puerto Rico, according to court documents. In March 2016, the Superintendence terminated the plan and informed the participants that the plan wasn't covered by ERISA because it was a church plan.

The participants argued that the church plan exemption didn't apply because while the plan was maintained by a church-affiliated entity, it wasn't established by the church. As such, they

claim that the administrators violated ERISA by failing to send required financial reports, pay annual premiums to the Pension Benefit Guaranty Corporation, diversify plan investments and take measures to prevent insolvency.

In siding with the participants, the magistrate judge noted the Superintendence's argument that it was an "integral part of the Catholic Church," but it didn't "go as far as to press the theory that the plan was established by the Catholic Church itself."

Church or Affiliated Entity

The fundamental thing is that this plan wasn't established by the Archdioceses of San Juan, Ferguson said. The only pension plans that are exempted from ERISA as church plans are those established by a church, and in this case the Superintendence isn't the church, Ferguson said.

The magistrate judge also took notice that the Archdioceses of San Juan has filed a document in a Puerto Rico state court claiming that the "Archdiocese is a separate and independent entity from the Catholic Church."

Even taking as true that the Superintendence and the schools it oversees are "integral" to the "mission and purpose" of the Catholic Church, this doesn't absolve the plan from the requirements that it be established by a church rather than a church-affiliated entity in order to qualify for ERISA's church-plan exemption, McGiverin said.

Much is at stake in this case, Amundaray-Rodríguez said. Although the plan was terminated, the assets haven't been distributed "out of caution," he said. If the case doesn't settle soon, this will be a long litigation where we can expect a $50 million judgment for the class, he said.

Mercado Soto Ronda Amundaray & Pascual and Carlos F. Lopez-Lopez represent the class.
Frank Zorrilla-Maldonado, Schuster & Aguilo LLC, Rabell-Mendez CSP and Barresi Law Office represent the Superintendence.

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Private Sector

Impact of the Proposed IRS Mortality Tables and Strategies to Reduce its Effects

Since late 2014, the Society of Actuaries (SOA) has been proposing updating the mortality tables used to determine the funding target liability for defined benefit (DB) plans under §430 of the code, with the mortality tables that were published by the Retirement Plans Experience Committee of the Society of Actuaries (RPEC) on October 27, 2014.

However, the IRS has deferred the adoption of the then newly published mortality tables, RP-2014 mortality table, for several years. On September 19, 2016, the IRS issued Notice 2016-50, which published the mortality tables that will be used for the 2017 plan year, and thus deferred the use of the new mortality tables for at least one additional year. The current basis for the IRS mortality tables is the SOA RP-2000 mortality table which is projected with Scale AA starting in the year 2000.

In the publication on October 27, 2014, the RPEC stated that the RP-2014 mortality tables are intended to reflect improvements in life expectancies with the MP-2014 projection scales. It was recommended by the SOA that the IRS adopt the RP-2014 mortality tables and the accompanying mortality improvement scale, MP-2014, as a replacement for the RP-2000 mortality tables and Scale AA. Due to the late-year publication date of the RP-2014 report, the tables could not be considered by the IRS, as it had already established the mortality tables for the 2015 plan year.

The SOA has since issued updates to better improve its projection scales. On October 8, 2015, the SOA issued the MP-2015 projection scale, incorporating additional mortality dates from the Social Security Administration from 2010 and 2011. The base RP-2014 mortality table had projections implicitly factored in when using the MP-2014 projection scales for years 2007 through 2014. Following the update to the projection scale, the SOA determined it would be appropriate to adjust the RP-2014 table by removing the implicitly reflected improvements, creating an RP-2014 table set to its base year in 2006 (later referred to as "Adjusted RP-2014"). In the 2015 report, it was stated that the SOA intended to publish annual updates to the projection scales.

On October 20, 2016, the SOA issued an additional update to the projection scales, the MP-2016 projection scale. The MP-2016 projection scale reflects three additional years of historical data from 2012, 2013, and 2014.

Despite the IRS continuing to use the older RP-2000 mortality table with projection Scale AA, they are considering the adoption of a variation of the Adjusted RP-2014 mortality table with an appropriate projection scale, with the earliest adoption being for the 2018 plan year.

The Impact

Since life expectancies are greater in the RP-2014 mortality tables compared to the RP-2000 mortality tables, there will likely be an increase in DB plans' funding target liabilities, which, in turn, will increase the plans' minimum funding requirements and PBGC premiums. The impact of changing mortality tables is dictated by the demographics of the plan. Exhibit 1 illustrates the comparison of life expectancies between the recently published 2017 IRS mortality tables and the Adjusted RP-2014 projected generationally with projection scale MP-2016. The table displays participant age as of the year 2017 and retirement at the age of 65. Additionally, Exhibit 2 compares the deferred to age 65 single life annuity factors.

EXHIBIT 1: Expected Future Lifetime of a Healthy Employee

	MALE			FEMALE		
Age in 2017	IRS 2017 Mortality Table	Adjusted RP-2014 Mortality Table with MP-2016	% Change	IRS 2017 Mortality Table	Adjusted RP-2014 Mortality Table with MP-2016	% Change
25	57.80	62.26	7.72%	59.68	64.88	8.72%
30	52.89	56.92	7.61%	54.72	59.50	8.73%
35	48.01	51.58	7.42%	49.79	54.13	8.71%
40	43.18	46.25	7.09%	44.88	48.78	8.69%
45	38.36	40.94	6.71%	39.99	43.45	8.67%
50	33.56	35.69	6.37%	35.13	38.18	8.68%
55	28.76	30.57	6.31%	30.34	32.99	8.72%
60	24.04	25.63	6.63%	25.69	27.89	8.57%
65	19.44	20.96	7.84%	21.16	22.90	8.25%
70	15.48	16.87	8.99%	17.23	18.55	7.67%
75	11.78	13.06	10.85%	13.61	14.50	6.54%

EXHIBIT 2: Single Life Annuity Factor for Healthy Employee Deferred to Age 65 at 6.00% / Annum						
	MALE			FEMALE		
Age in 2017	IRS 2017 Mortality Table	Adjusted RP-2014 Mortality Table with MP-2016	% Change	IRS 2017 Mortality Table	Adjusted RP-2014 Mortality Table with MP-2016	% Change
25	1.0133	1.1192	10.45%	1.0573	1.1945	12.98%
30	1.3581	1.4832	9.21%	1.4160	1.5851	11.94%
35	1.8219	1.9658	7.90%	1.8974	2.1036	10.87%
40	2.4473	2.6060	6.48%	2.5438	2.7926	9.78%
45	3.2895	3.4566	5.08%	3.4132	3.7095	8.68%
50	4.4258	4.5936	3.79%	4.5849	4.9336	7.60%
55	5.9617	6.1302	2.83%	6.1753	6.5781	6.52%
60	8.0633	8.2458	2.26%	8.3694	8.8104	5.27%
65	10.9921	11.2676	2.51%	11.4255	11.8733	3.92%
70	9.5960	9.9622	3.82%	10.1649	10.5921	4.20%
75	7.9942	8.4696	5.95%	8.7605	9.1101	3.99%

Many plan sponsors have already updated to the Adjusted RP-2014 for financial reporting purposes, and have thus experienced the impact of switching from the RP-2000 mortality table. Plan sponsors can expect a similar impact on their funding liabilities.

Some common plan sponsor objectives may be affected or delayed by the implementation of the proposed mortality tables, they include:

- Eventual termination of the DB plan
- Fully funding the plan
- Reduction of contribution amounts and volatility in required contributions
- Reduction of PBGC premiums
- Reduction of administration cost

Potential Strategies to Minimize Impact

It may be good news for plan sponsors that the IRS is delaying the implementation of the new mortality tables, as it allows time to plan accordingly for the potential increase. There are several strategies that a plan sponsor may want to employ based on their objectives. Pension Risk Management (PRM) is a collection of salient strategies, all of which are aimed at reducing the volatility of risk associated with DB plans. Generally speaking, the strategies fall into one of four categories:

- Plan design
- Funding strategies
- Investment strategies
- Risk transfers
- Plan Design

A popular strategy for plan sponsors is the addition of a lump sum option that will allow prospective terminated or retired employees to withdraw the value of their DB plan benefit. This is analogous to withdrawing a defined contribution (DC) account balance. The participants who elect this type of option would receive their benefit in the form of a single sum distribution, with the ability to transfer the funds to an IRA or a prospective employer's plan. Typically, participants who elect a lump sum distribution are younger in age. With the proposed mortality table having longer life expectancies than the current statutory table, lump sums in the future will be larger. When the lump sum is distributed, the participants are no longer participating in the plan and are not required to be reflected in the valuation. This helps the plan sponsor reduce the plan's liability, since the participants would no longer be valued in the valuation, reducing the required PBGC premium due to the reduction in head counts and liability, and reducing administrative costs of the plan.

Another consideration for the plan sponsor is to close the plan to new entrants. This allows existing employees to continue to accrue future benefits in the current DB plan, while new employees earn benefits under a separate plan, typically a DC plan. Closing the plan to new entrants both reduces the possible increase in head counts and, in turn, lowers future liabilities in the DB plan.

Additionally, a plan sponsor may consider freezing benefit accruals, eliminating the employee's ability to accrue additional benefits under the current DB plan and providing future benefits in a separate plan, typically a DC plan, instead. All benefits earned prior to the freeze remain in the DB plan, subject to the plan's vesting and eligibility requirements. Existing employees have benefits from two separate plans, one frozen DB plan for historical benefits and a replacement DC plan for future benefits, while new employees earn benefits from only the DC plan.

Funding Strategies

By increasing funding above the statutory minimum, a plan sponsor may increase the plan's funding status. The funding status is dependent on the investment performance of the plan's assets, which are professionally managed. If the funding status is sufficient, the plan may be exempt from statutory minimum cash contributions.

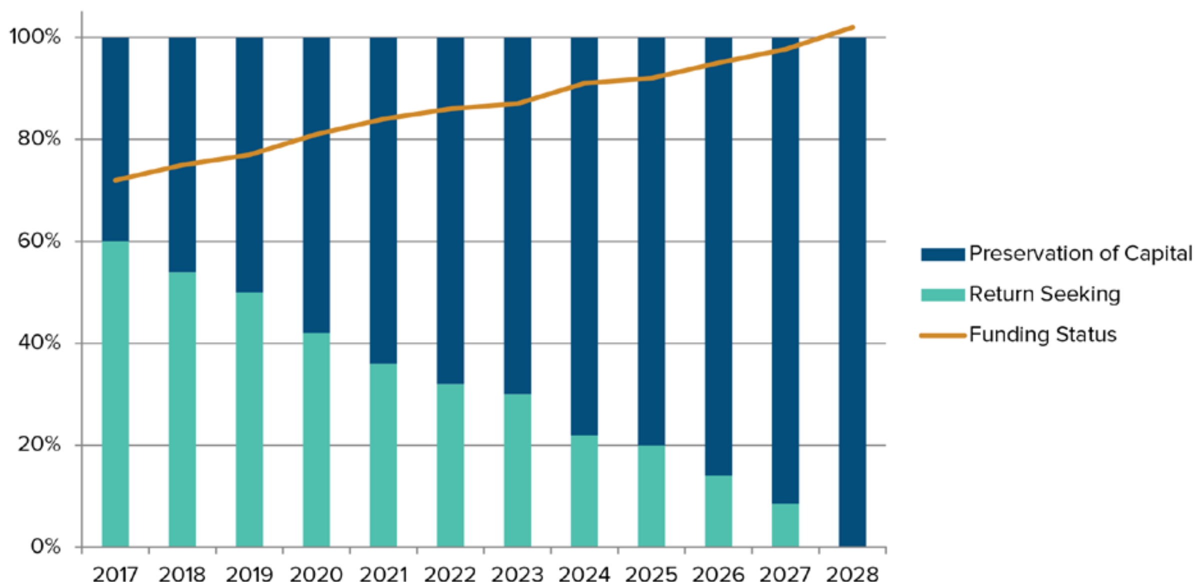
A byproduct of contributing above the statutory minimum is the ability to build a Pre-funding Balance. Pre-funding Balances may be used in place of making cash contributions in order to satisfy the statutory minimum. A plan sponsor can opt to make additional contributions sooner rather than later to strategically pre-fund the plan. When the newly-proposed mortality tables are implemented, the plan could use the Pre-funding Balance to stabilize cash contributions in order to satisfy the statutory minimum.

Investment Strategies

Plan sponsors may consider changing their investment strategies to reduce the volatility in statutory minimum contributions. One option to consider is Liability Driven Investments (LDI). Under LDI, the assets move in tandem with the liability, reducing the volatility of the funding status and, in turn, reducing the volatility of the statutory minimum contributions. The goal under LDI is not to maximize investment returns, so it is not recommended for plans that are underfunded.

A plan sponsor may also consider a Dynamic Asset Allocation (DAA). The concept of DAA is popular among DC plans in the form of "target date" or "glide path" funds. In DC plans, the asset allocation of a participant's account balance changes over time. For younger participants, the asset allocation is heavily focused on investment returns. As a participant grows closer to retirement age, the asset allocation slowly changes over time to focus on investments with potentially lower returns but less volatility. The same concept can be applied to the assets in a DB plan. The sponsor of a plan that is underfunded may opt to allocate the majority of the plan's assets into return-seeking funds that offer higher returns but have more volatility, while the remaining assets are allocated to capital preservation funds that offer lower returns with lower volatility. The goal under DAA is for the plan to reach a funding status where it is either fully invested in an LDI strategy or is in a position to terminate. Exhibit 3 illustrates how the plan's asset allocation changes over time as the plan's funding status improves.

EXHIBIT 3



Settlement Strategies

Settlement strategies are methods that a plan sponsor may consider in order to “buy out” a participant’s benefit. Two such methods are bulk lump sums and annuity purchases. The goal of both methods is to remove participants from the plan, lowering PBGC premiums and liability. If one or both methods are employed by the plan sponsor, the proposed updated mortality table will have no effect on the participants, since they would no longer be part of future valuations.

Lump sum windows may be distributed to all former employees. If the DB plan does not have a prospective lump sum option, employees who terminate must wait until they become eligible to retire, which could be many years in the future. The plan sponsor can offer a lump sum to all former employees via a “window,” which would reduce the plan’s liability for each participant who elects the lump sum distribution.

A variant of the lump sum window is a window that targets a select group of former employees, for example, sums below a specified dollar amount. If elected, this permits the distribution of lump sums for small benefit amounts. An analysis is typically prepared to identify the specified dollar amount, or threshold, taking into account:

- The plan’s Adjusted Funding Target Attainment Percentage (“AFTAP”)
- The plan’s risk of Settlement Accounting under ASC 715
- Prospective savings in PBGC premiums
- Prospective savings in administrative costs

Another method a plan sponsor may utilize is annuity purchases. Annuity purchases are typically used for current retirees in the plan. The plan will distribute assets from the DB plan’s trust to a third-party insurance carrier that assumes the obligation to pay the monthly distributions. Annuity purchases can also be adapted for current active participants and former participants that are vested in a benefit. With annuity purchases, the participant’s monthly benefit payment or benefit options available under the DB plan are preserved.

Conclusion

It is unknown when the IRS will implement the new mortality tables, but it could be as early as the 2018 plan year. During the pending time period, plan sponsors should consider PRM strategies to minimize the impact a new mortality table may have on their DB plan. The sooner plan sponsors assess the risk in their DB plans, the better their situation will be when the proposed changes are implemented.

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Returns strong in 2016 despite scary beginning

An eventful year filled with geopolitical drama, market volatility and diverging monetary policy gave rise to some impressive returns for pension funds in seven of the world's largest retirement markets. The average investment returns for pension funds in Australia, Canada, Japan, the Netherlands, Switzerland, the U.K. and the U.S. were higher in 2016 than the year before and ranged from the U.K.'s 20% to a 2.8% average for Japanese funds.

The year started with a stock market crash in China and an increasingly accommodative monetary policy from the Bank of Japan, followed by the U.K.'s shock vote to leave the European Union. Commodity prices began to regain ground, and the year ended with the election of Donald Trump as U.S. president.

But the volatility created by these events looks to have played to the advantage of pension funds, at least at first glance, said sources.

Global pension fund returns for 2016

	U.K.	Netherlands	Australia	U.S.	Canada	Switzerland	Japan
RETURN:	20.0%	7.3%	7.2%	6.7%	6.5%	4.2%	2.8%
INFLATION:	1.60%	1.00%	1.30%[1]	2.10%	1.23%[1]	-0.27%	0.50%[2]
REAL RETURN:	**18.40%**	**6.30%**	**5.90%**	**4.60%**	**5.27%**	**4.47%**	**2.30%**

[1]Data are as of September. [2]Data are as of November.

The U.K. was by far the market with the highest average return, at an estimated 20%. That compares with a range of zero to 2% for 2015.

“Brexit was the more significant (event) for U.K. pension funds,” said Phil Edwards, Bristol, England-based principal and European director of strategic research at Mercer Ltd. “There was a large devaluation in sterling, a large fall in gilt yields and the FTSE 100 rose fairly materially

after that event."

Between June 24 and the end of the year, the pound sterling fell 17.05% against the dollar, while the FTSE All-Share index rose 5.52% in dollar terms. For the year, the pound dropped 16.26% vs. the dollar, while the FTSE All-Share gained 16.75% in dollar terms.

U.K. pension funds that had little or no currency hedge on their overseas assets will have reaped richest benefits of currency moves. But "almost all schemes will have benefited to some extent," Mr. Edwards said.

Allocations to growth fixed-income assets such as local currency emerging market debt and high-yield bonds "will have seen decent returns from that part of the portfolio," he said.

However, there is a counterpoint to the stellar returns for U.K. pension funds: A drop in gilt yields after the Brexit vote has pushed liabilities up. Mr. Edwards estimated liabilities are probably up around 20% to 25% for the year. "Even though assets rose over the course (of 2016), with strong returns overall, funding levels will have moved much less than that as liability valuations" also were up.

But there would have been moments of opportunity in inflated asset levels for pension funds. "Defined benefit schemes are on a path to gradually derisk away from equities toward lower risk portfolios. More and more schemes now have derisking triggers in place," said Mr. Edwards, meaning as a funded level rises to a certain point, assets are moved into bonds and less risky exposures. Given equity rallies toward the end of the year and increased yields, "we will have seen a number of schemes going through derisking triggers."

Flat funded status

Little movement in funded levels was also a theme in the Netherlands, said Mercer principals and investment consultants Edward Krijgsman and Dennis van Ek, both based in Amstelveen. Pension funds started the year 102% funded, and finished at the same level. "However, the 102% we started with went below 95% in March but recovered," said Mr. Krijgsman.

A decrease in interest rates in 2016, pushing fixed-income allocations into positive performance, was beneficial to Dutch pension funds but did harm funding levels. Mr. Krijgsman said these funds have a relatively high interest rate hedge, around 40% of the market rate of liabilities. Messrs. Krijgsman and van Ek put the average pension fund return at 7.3% vs. 1.1% in 2015. "That lies very close to the performance of the average Dutch pension fund on their

fixed-income portfolio, about 6.8%," said Mr. Krijgsman. Equities also performed well, with the MSCI Europe index gaining 3.1% in dollar terms.

An average 50% currency hedge will also have helped bolster returns, as the euro fell about 3% against the dollar. Executives at Mercer have and will be encouraging clients to look carefully at their currency hedges going forward. "We don't favor 100% hedges on all currencies, or any one hedge. The U.S. dollar can offer some favorable (advantages) when there is a problem in the eurozone," said Mr. van Ek. And with important elections coming up in European countries and ongoing accommodative monetary policy, "even with the unrest in the U.S. with (Mr.) Trump, we see certain exposure may be desirable, simply from a risk strategy," he added.

However, the fall in sterling makes that currency less attractive, and "it would be wise to have a large hedge on that," he said.

Australia improves

Australian pension funds came next in the ranking, with an average 7.2% return, up from 5.6% a year earlier, showed data from SuperRatings Pty Ltd. The so-called Santa rally in December contributed 2.1% to overall returns, and the Australian dollar fell 1.1% against the U.S. dollar.

The Australia stock market, the ASX 200, also gained 11.79% in 2016 in U.S. dollar terms.

U.S. pension funds clearly benefited from the strong U.S. dollar, and returns reached 6.7% according to Willis Towers Watson PLC. That compares with -0.8% for 2015.

Last year was a "pretty good year for equities," said Alan Glickstein, a senior consultant at Willis Towers Watson in Dallas. The Russell 3000 gained 12.74% over the year. That would have benefited U.S. funds, which had an average 63% allocation to domestic equities at year-end 2015.

But it was not all clear sailing. The funded status of the average plan hovered around 80%. Also noteworthy is "how dramatically different things would have been if we ended the year the day before our elections," Mr. Glickstein said, referring to the Nov. 8 U.S. presidential election. "Things would have been much worse," with a funded status probably around 75% or a little less, the lowest level Willis Towers Watson has seen in its analysis. Equities were not performing as well, and rates were much lower. "Immediately after (the election) liabilities dropped a bit and equities were up. So that sort of saved us from what would have been an

ugly year from a funded perspective, to one that looks pretty flat," added Mr. Glickstein.

Canada rebounds

Moving north, Canadian pension fund returns came next, with an estimated 6.5% return on the typical 60-40 portfolio, said Bruce Curwood, director, investment strategy at Russell Investments Canada in Toronto. While volatility hit global markets, Canadian plans fared well based on three major, interrelated issues: rebounds in material and energy prices; a resulting 21.08% gain in U.S. dollar terms for the Canadian stock market, the S&P/ TSX; and increased Canadian bond yields.

"Even with a soft economy, subdued domestic growth and low inflation, Canadian bond yields increased across the board this past year, decreasing pension liabilities, yet still managing to provide a positive investment return" of 1.7% for the FTSE TMX Universe in Canadian dollar terms, said Mr. Curwood.

Last year "was almost a complete reversal from the poor year Canada experienced in 2015 for commodities, the Canadian stock market and domestic Canadian interest rates," he added. He said Canadian funds will have "gained ground in their fight for 100% solvency funding," as rising interest rates decreased liabilities, while assets increased in value.

Swiss pension funds also made a marked improvement on their 2015 returns, hitting an estimated 4.2% vs. 0.7% a year previous, estimated Daniel Blatter, senior analyst at WTW in Zurich. Pension funds made small shifts out of bonds in favor of alternatives and real estate, and equities saw a small increase in terms of the proportion of overseas exposure. "The key driver of decisions on investment strategy in 2016 has been the low/negative interest rate environment with Swiss government bond yields below zero for much of the curve," Mr. Blatter said.

This, along with fears of the effects of negative interest rates on fixed-income portfolios, has led to moves away from bonds, he said. "Given the subdued return expectations together with high risks associated with equities, our clients have sought to improve portfolio diversification by moving into alternative assets such as insurance-linked securities."

Japan lags

The final pension fund market analyzed by Pensions & Investments was Japan, with an average 2.8% return for Russell Investments' universe of corporate pension funds. That compares with

a less than 2% estimate for 2015. Fixed income was also a focus for pension fund executives, thanks to the unexpected introduction in January of a negative interest rate by Haruhiko Kuroda, governor of the Bank of Japan. "As a result, the yield of the 10-year JGB became negative, and dealing with domestic fixed income became the most interesting topic in 2016," said Konosuke Kita, director of consulting at Russell Investments in Tokyo. Investors moved out of Japanese fixed income and into assets such as hedged international fixed income and alternatives, or took steps to control the risk level in Japanese fixed income, he said.

Derisking has remained a theme for corporate plans in Japan, with decreasing domestic and international equity allocations. Public plans, however, have been increasing their equity allocations, adjusting them to meet 2015-set policy allocations of 50%.

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New Spectrem Group Report Analyzes Attitudes, Behaviors and Concerns of Recent and Long-Term Retirees in America

A new Spectrem Group study that examines the attitudes, behaviors and concerns of recent retirees (those who've been out of the workforce less than a decade) and those retired for 20 years or more, reveals overwhelming satisfaction with their life in retirement.

According to Fnancal Wellness n Retrement, a whopping eight out of ten (79 percent) U.S. retirees find life in retirement better than they had originally anticipated. At the same time, however, the report shows that nearly half (45 percent) of retirees failed to begin planning until just five years before they left the workforce, with nearly a quarter (24 percent) acknowledging that it wasn't until the year they retired that they started planning for life after work.

The quantitative portion of the study indicates that just over half (53 percent) of retirees sought professional advice for their retirement planning, with nearly a third (29 percent) indicating that the reason they didn't was that in their opinion professional retirement planning services cost more than the value delivered.

Once retired, the lion's share of retirees' monthly income comes from pensions and Social Security, which together comprise 58 percent of monthly cash flow among those surveyed. Nearly seven in ten (68 percent) retirees said they use a financial advisor. While retirees share common everyday concerns about budgeting and spending, the single greatest challenge they expressed was in managing and dealing with medical care, a concern shared by one in four (25

percent) retirees.

Other key findings include:
"The good news is that most retirees are in the enviable position to pursue new interests, step back from the day-to-day stresses of life, and spend more time with their family," said Spectrem President George H. Walper, Jr. "However, ensuring sufficient income in retirement requires advanced planning. Our research has found that retirees who receive help from an advisor in planning for retirement often appreciate the fact that a plan is in place, and are reassured that their assets will likely outlive them."
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PBGC STICKS ITS HEAD OUT OF THE WATER AND ISSUES RFI REGARDING HYBRID (TWO-POOL) MULTIEMPLOYER PENSION PLANS

Seyfarth Synopsis: The PBGC is seeking more information on hybrid or two-pool withdrawal liability calculation methods. This is a sign that the PBGC may be re-evaluating its role in approving hybrid proposals, although it may be too early to tell which way it will dive, especially under a Trump administration.

The Pension Benefit Guaranty Corporation (PBGC) issued a Request For Information (RFI) , to be published January 5, 2017, asking 24 questions about hybrid or two-pool alternative arrangements for multiemployer pension plans. Under a hybrid plan arrangement, a plan creates two pools for withdrawal liability purposes: The old pool for the “old employers,” and a new pool for “new employers” (and those old employers who “withdraw” from the old pool and move to the new pool). New employers are generally assessed withdrawal liability under a direct attribution method, and are not subject to the unfunded vested benefit liability of the old pool. Old pool members who agree to withdraw, pay their old pool liability, and move to the new pool often receive special considerations such as discounted withdrawal liability, lower contribution increases, and waivers of some or all potential old pool mass withdrawal liability risk. Funds began seeking PBGC approval for hybrid plans as a way to generate revenue, entice new employers to participate, and provide old employers concerned about their withdrawal liability risk a way to pay their current liability and continue to participate at a reduced risk.

Since 2011 the PBGC has received approximately 20 requests for approval of hybrid withdrawal liability arrangements. Notable plans that have had their requests approved include the Central States and New England Teamsters Pension Funds. When the first plans submitted their requests, the PBGC had not been asked to — nor did it — take into consideration the benefits offered existing employers to move to the new pool. Some plans offered considerable deals in terms of discounted assessments, frozen contribution rates, and mass withdrawal

relief. In its RFI, the PBGC admits that, had it known of the terms of the settlements offered employers to move to the new pools, that "could have affected PBGC's analysis of whether the statutory criteria [for adopting an alternative assessment method] had been satisfied." The PBGC has since begun to analyze proposed withdrawal liability settlement terms to see how that impacts any potential risk of loss and the overall validity of a proposed hybrid arrangement.

The PBGC in its RFI is particularly interested in learning about the terms and conditions that apply to new and existing employers that enter into hybrid arrangements, including alternative benefit schedules, special withdrawal and mass withdrawal payment terms, alternative withdrawal liability arrangements, and the pros and cons of such hybrid arrangements for participants and the PBGC as the insurer of multiemployer plans. Some of the more interesting queries include:

- How the PBGC should factor in discounted withdrawal liability settlements and changes to plan mass withdrawal liability rules in its determination of whether to approve a hybrid plan arrangement, and whether the PBGC should approve proposed withdrawal liability payment terms and conditions.
- Whether plans that have adopted a hybrid model have increased their contribution base (i.e., did they add employers or at least more participating employees as intended) or retain employers that otherwise would have withdrawn.
- Whether there have been legal challenges to the hybrid model, and what role collective bargaining played in creating and implementing such models.
- Whether plans are considering other alternative arrangements for withdrawal liability that would address the concerns addressed by the hybrid arrangement.

The PBGC also has asked what information and resources it can provide to interested parties about the innovative means plans are using in alternative withdrawal liability arrangements and what it can provide regarding the PBGC's process for considering hybrid models.

What is unclear is where the responses to an Obama PBGC RFI may take the Trump PBGC. Will it assume more oversight of such arrangements, or less? Will it support alternatives or oppose them? As for current pending proposals, the PBGC claims the RFI is independent of and without prejudice to its ongoing review of those requests. Yet some of those requests have been pending for a very long time.

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Small Companies Have a Big Retirement Problem

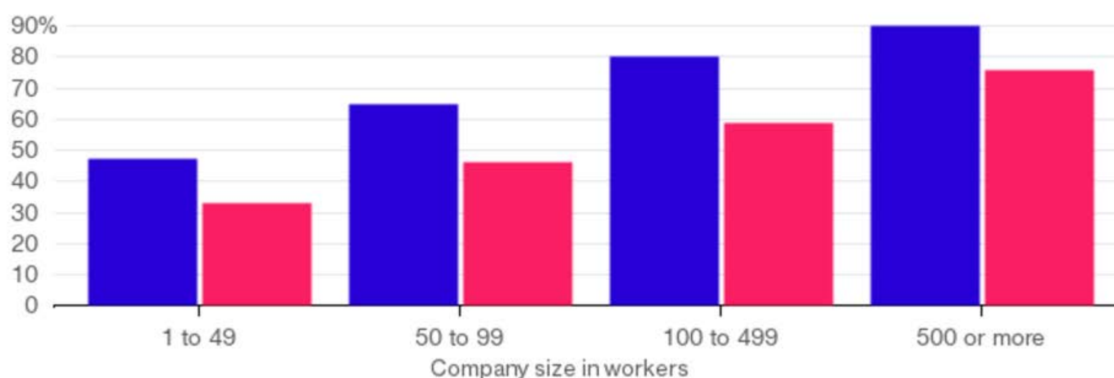
Thinking about taking a job at a small company? Don’t expect a good retirement plan.

At companies with fewer than 50 workers, not even half the employees have access to a 401(k) or pension, according to the Bureau of Labor Statistics. At companies with 500 workers or more, 90 percent of employees have access to a retirement plan.

The Big Business Retirement Advantage

Availability and use of retirement plans, by company size.

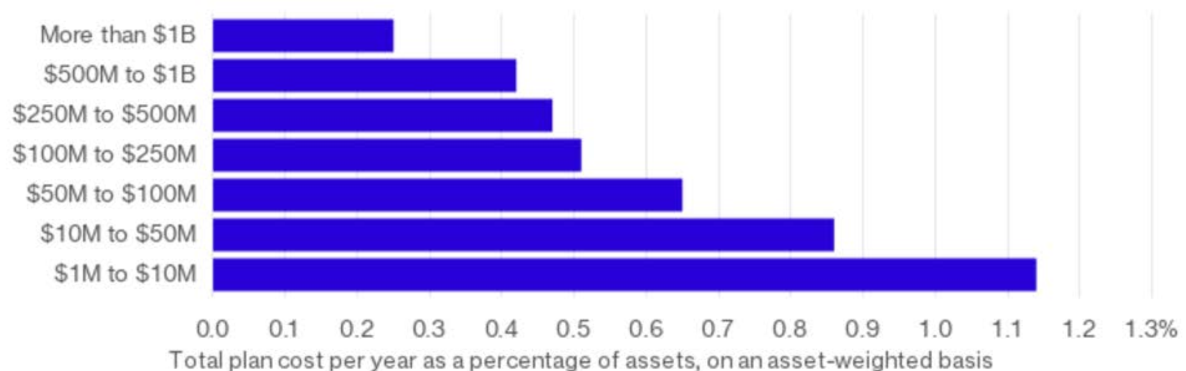
Percentage with access to a pension or 401(k) Share participating in a plan



Bureau of Labor Statistics

This gives large corporations a huge advantage in hiring talented people, and it leaves millions of Americans without an easy way to save for their futures. Companies with fewer than 100 workers employ 36 percent of the U.S. workforce, or about 42 million people.

Even when small companies do have a retirement plan, it is likely to be astronomically more expensive than those offered by large companies. These high fees eat away at returns, making saving for retirement far more difficult than it needs to be.

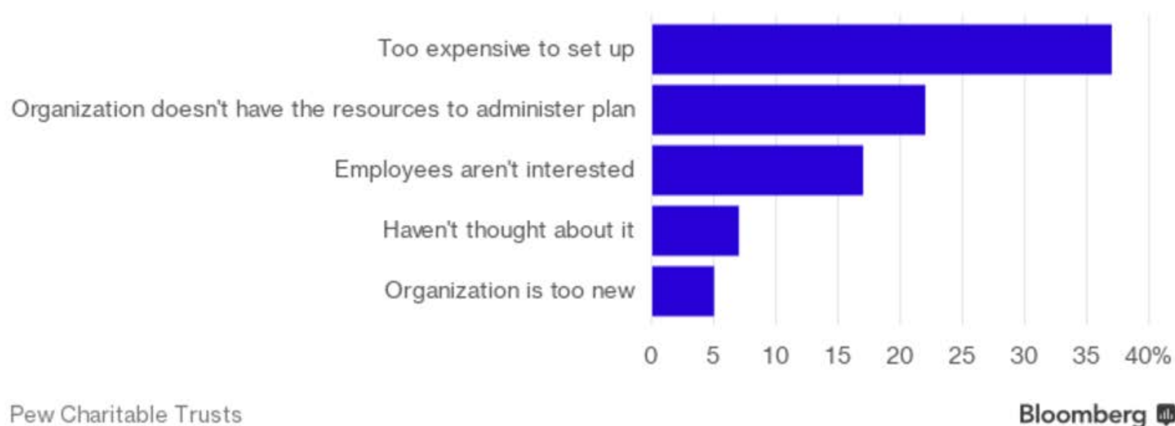


Lawmakers in Washington and in several states are exploring ways to make it easier for more Americans to save for retirement. They're especially focused on employees of smaller companies, who—along with part-timers—are the least likely to get a 401(k) or pension. Small-business owners aren't enthusiastic about all these policy proposals, according to a new survey by the Pew Charitable Trusts, but most recognize the retirement problem they face.

The smaller a business is, the less time and money it usually has the luxury of spending on a retirement plan. Small-business revenues tend to be unpredictable, making it difficult to commit to matching 401(k) contributions every year, said Larry Sher, an actuary who helps design retirement plans as a partner at October Three Consulting. Even when small companies have the money, they might not have a staff member who knows how to set up and administer a retirement plan properly.

Then there's the cost of hiring an outside firm to set up and administer a 401(k) plan. These costs can be considerable when are few employees to share the burden. While some low-cost, no-frills 401(k) plans are now available to small businesses, many instead go through local financial advisers who charge hefty fees.

It's a lot easier to just skip offering a 401(k). Cost was the main reason owners of small and medium-size businesses didn't offer a retirement plan, Pew found in its survey, followed by worries about administering the plans.



Five states are in the midst of shaping bold plans to change all this. California, Maryland, Oregon, Illinois, and Connecticut are all setting up portable individual retirement accounts that can follow workers through their careers. Each state is requiring employers either to offer a retirement plan or to sign workers up for state-run, automatic IRAs. In California, for example, the mandate will eventually apply to all companies with five or more employees.

The Pew Charitable Trusts asked business owners what they think, surveying more than 1,600 companies with from five to 250 employees. The majority liked the general idea of an auto-IRA plan, with 27 percent strongly supporting and 59 percent somewhat supporting the concept.

Still, business owners were skeptical about the government getting involved. Just 41 percent supported the federal government sponsoring auto-IRAs, with 59 percent opposed, and just 44 percent supported state government-sponsored auto-IRAs. By contrast, 82 percent liked the idea of mutual fund companies sponsoring auto-IRAs, and 72 percent favored insurance companies running the program.

It's not clear how these business owners will feel about specific auto-IRA programs when they're rolled out over the next few years. The auto-IRAs are technically public-private partnerships, with state governments planning to hire private investment managers to administer the accounts.

"The good news is that small-business owners are receptive to policy solutions, because they do have a problem on their hands," said John Scott, director of Pew's retirement savings

project.

The top reason business owners said they support the auto-IRA concept was that "it would help my employees." Poor retirement options (and no retirement options at all) cause problems in the workplace, and not just with recruiting. "If employees don't have some money set aside, how are they going to retire?" said Sher, the actuary. Business owners tend to want an "orderly transition to retirement," he said, one that lets older workers stop working if they want, giving employers the chance to groom younger workers for promotions.

Other ideas at the state and federal levels may appeal more to business owners than auto-IRAs do. New Jersey and Washington State are setting up retirement plan marketplaces—state-run websites on which employers could shop for lower-cost retirement plans. All but 14 percent of business owners told Pew they like this idea.

Utah Senator Orrin Hatch, the Republican chairman of the Senate Finance Committee, has proposed offering additional incentives for small businesses to set up retirement plans. He would also make it easier for employers to join so-called "multiple employer plans," allowing businesses to join forces to share the costs of offering a plan. "I look forward to working with my fellow Finance Committee members and senate leadership on how to get these much-needed policies enacted into law," Hatch said in a statement.

Perhaps it's natural for business owners to prefer incentives to government mandates—and just as natural for employees to prefer the mandates. In a survey released in November by Natixis Global Asset Management, almost 80 percent of U.S. workers said employers should be required to offer retirement plans. Almost three-quarters said companies should have to make contributions to their retirement account, something no state is currently planning to require.

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