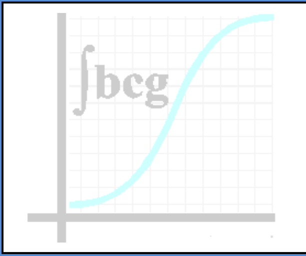

BCG Retirement News Roundup

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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.

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Public Sector/Government Plans

Impact of union's new retirement plan on city pension fund uncertain

When the Kenney administration announced its new contract with the city's blue-collar union on Friday, it suggested that changes to the union's retirement plan would benefit the city's underfunded pension fund.

"Making the pension fund sustainable has been a key goal of my administration from the beginning," Mayor Kenney said in the announcement of the $175 million four-year contract.

But when questioned this week, administration officials could not say by how much the pension deficit would be reduced given the changes. The city is $5.9 billion short of its $11 billion pension liability, making it one of the worst-funded public pension plans in the country.

"The pension plan's actuary will determine the impact of this proposal on the pension fund," city spokesman Mike Dunn said in an email.

City Finance Director Rob Dubow said Wednesday that the city had studied the impact of some of the proposed changes to the union's pension plan and found they would accelerate the reduction of the pension shortfall. He said it had not analyzed how the final settlement numbers would ultimately affect the pension fund.

Terms of the new contracts are as follows: Current employees with a base salary of more than $45,000 a year will pay between 0.5 percent and 3 percent more toward their pension, depending on their salary bracket. For example, those earning $55,000 to $75,000 will contribute 1.5 percent and those earning $100,000 or more will pay 3 percent more.

Currently, most D.C. 33 employees contribute 3 percent of their pay into the pension fund. As part of the contract, the controversial Deferred Retirement Option Plan (DROP) will remain, with future participants earning 0.5 percent interest in their four-year DROP account.

Only a third of D.C. 33's 7,900 city workers would have to contribute more. The average salary of a D.C. 33 employee is about $38,000, according to city officials.

The city will institute what it is calling a "stacked hybrid" pension fund for new hires. Employees will still receive the standard defined pension plan based on what they earn up to $50,000 a year. Above that, they can enroll in a 401(k)-type plan. The city will match half of the employee's contribution up to 1.5 percent of annual compensation.

The contract also includes 3 percent raises for all 7,000 union members working in city government for its first, second, and fourth years. In Year 3, employees will receive a 2.5 percent raise, for a total wage increase of 11.5 percent over the contract's lifetime.

The annual rate of inflation has not exceeded 2 percent in the last four years, according to the U.S. Bureau of Labor Statistics.

Francis Ryan, a labor studies professor at Rutgers University who wrote a book on the history of the Philadelphia AFSCME union, said the contract was one of the more generous seen in recent mayoral administrations. He said that under the Tate and Rizzo administrations of the 1960s and 1970s, contracts were particularly positive for the union, but added that "today's climate is very different."

"It's very rare that a union of sanitation workers and crossing guards and City Hall clerks are able to get any kind of raise," Ryan said. "In many ways they're maintaining their jobs from being cut."

Councilwoman Maria Quiñones-Sánchez, chairwoman of Council's Appropriations Committee, said the raises were long overdue, considering that the city's blue-collar union is its lowest paid and that its workers went without raises for much of the recession.

"They've put, as we would say, a lot of skin in the game," she said. "And they deserve this."

The administration, however, has not specified how it will pay for the raises, only that it will find the money within the five-year plan.

Rick Dreyfuss, an actuary and a senior fellow at the Harrisburg-based think tank Commonwealth Foundation, said the lack of specificity should raise red flags for Philadelphia taxpayers.

"The fundamental driver of any labor contract should be the employer's ability to pay," Dreyfuss said. "When I see 3 percent increases, how is Philadelphia fiscally able to afford this?"

On the retirement front, Dreyfuss said that increased contributions were a good thing but didn't solve the more immediate issue.

"You still have a $6 billion deficit," he said. "This doesn't increase it, but it also doesn't decrease it."

Sam Katz, former chairman of the city fiscal watchdog Philadelphia Intergovernmental Cooperration Authority, echoed Dreyfuss' comments by saying the contract had some positive aspects but didn't address "the problem."

"Anything that doesn't deal with today's problem [the $6 billion deficit] is a distraction and enables people to avoid the inevitable," Katz said, referencing possible liquidity and a growing budget crisis every year. "The pension crisis in Philadelphia is hidden in plain sight."

Quiñones-Sánchez said that the pension crisis was the product of earlier pension plans and that to try to fix it with a contract that will affect more recent hires was unfair.

"We cannot pay for bad policies off their backs," she said.

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New Jersey amendment guaranteeing pension contributions moves closer to ballot

The New Jersey State Assembly on Monday voted to place a constitutional amendment before voters in November guaranteeing state contributions to the $70.9 billion New Jersey Pension Fund, Trenton, and making sure payments are made quarterly rather than at the end of the year.

The vote passed 50-25 with two abstentions. The state Senate hasn't voted yet. Both houses are controlled by Democrats, and Gov. Chris Christie, a Republican, cannot veto a constitutional amendment resolution. Mr. Christie opposes the proposed amendment.

Both chambers approved proposals in the previous legislative session that ended in January, but their votes fell short of the state law allowing an amendment for voter consideration after one-time legislative votes. So, legislators must vote again with simple majorities needed to approve the proposal.

Democratic supporters say the amendment will offer consistency in offering steadily rising

state payments to the pension fund and will guard against any governor making last-minute cuts in payment promises.

For fiscal 2014 and 2015, Mr. Christie reduced the promised state contributions, citing the constitutional requirement that the state have a balanced budget each fiscal year. The cuts survived legal challenges. Mr. Christie also made a contribution to the pension fund for the current fiscal year that was less than state law required.

Supporters of the proposed constitutional amendment said they acted in response to a 2015 state Supreme Court ruling that state payments to the pension fund weren't guaranteed by the state constitution.

Mr. Christie and fellow Republicans said the proposed amendment would force the state to make pension fund contributions regardless of financial events affecting the state, leading to the prospect of significant cuts in other areas or higher taxes in order for the state to meet its constitutional requirement of a balanced budget for each fiscal year.

Separately on Monday, the state Assembly and Senate overwhelmingly approved a bill to prohibit the New Jersey Pension Fund from investing in any company that boycotts, divests from or sanctions Israel or Israeli business, or boycotts companies operating in Israel or Israel-led territory. The prohibitions don't apply to companies providing "humanitarian aid to the Palestinian people," the bill said.

The Assembly approved the bill 70-3 with two abstentions. The Senate approved the bill 37-0.

It now goes to Mr. Christie for approval.

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Schuh proposes cutting pension oversight group

A citizens' group responsible for considering changes to county employees' pension plans could be dissolved under Anne Arundel County Executive Steve Schuh's latest charter amendment proposal.

The measure would eliminate a section in the charter that requires the county to convene the Pension Oversight Commission, a nine-member body appointed by the county executive and confirmed by the County Council.

Schuh's aides say the commission, which rarely meets, is obsolete and should be disbanded as part of a broader push to cut red tape throughout county government.

"It's a reduction of an unnecessary and outdated commission whose functions are being handled by another area of government," said Schuh spokesman Owen McEvoy.

But the head of the commission defended the group's relevance, arguing it provides an extra level of checks and balances on a system that handles more than a billion dollars that thousands of county employees depend upon when they retire.

"I think there are some elected officials who don't appreciate oversight; they don't appreciate other opinions and they want to push legislation through without that legislation being properly vetted," Pension Oversight Commission Chairman O'Brien Atkinson said.

The council will hold a hearing on the proposed change Tuesday. Charter amendments must be endorsed by five out of seven council members to be put on the general election ballot for voters to decide.

Oversight of Anne Arundel County's pension funds — which totaled about $1.6 billion at the end of 2015 — has been modified several times, resulting in two bodies charged with watching over the system.

The Pension Oversight Commission was formed in 1982 following concerns about the county's formulation of pension benefits. It is composed of five residents with knowledge of pension administration as well as four employees of the county's classified service.

The charter gives the commission a 30-day comment period before the county is allowed to make any legislative changes to the pension plan's funding methods.

In 1996, then-County Executive John G. Gary created the second group, which holds more sway.

The Retirement and Pension System Board of Trustees meets monthly to hear updates from the pension system's financial managers and votes to approve a budget for the system each year.

The 13-member board — which includes county administrators, retirement plan participants, union representatives and local residents — is partly appointed by the county executive and partly elected by stakeholder groups.

McEvoy said the bodies' responsibilities overlap.

"The Board of Trustees handles 95 percent of the duties that had been assigned to the Pension Oversight Commission," he said. "There was a duplication of efforts."

County Budget Officer John Hammond, who sits on the Board of Trustees, agreed.

"You've got this body that has essentially the same membership (as the Pension Oversight Commission)," he said. "From a practical standpoint, it really has resulted in the lack of a need for the (commission)."

McEvoy and Hammond both noted the commission rarely meets and hasn't issued a report recently. Though the charter requires commissioners to compile an annual status report on the pension system, the Board of Trustees has since taken over that responsibility.

Members continue to be appointed to the commission, however. Schuh recently nominated three commissioners — Karl Appel, Brian Chisholm and Elizabeth Jane Buck — whose terms began in February and are set to expire at the end of January 2020.

Atkinson, who is also president of the county's police officers union, said the commission meets sporadically because its members' opinions are needed only when legislation could impact the pension system — and there hasn't been any such legislation recently, though the commission did weigh in last summer on a Schuh administration bill that sought to change the way retirement dates are determined for the county attorney and police chief. The commission opposed the change, which was ultimately passed in an amended form.

Some years are busier than others, Atkinson said.

"We have a very good, well-established pension system in Anne Arundel County that doesn't need change or updating," he said. "However, there have been years when we have six or seven pieces of pension legislation that we have to make recommendations on."

Atkinson said he felt "blindsided" by the proposed charter change.

"The Pension Oversight Commission is anything but defunct, and we have engaged on every pension issue that has come up before the County Council."

The council will have to act relatively fast — charter changes must be approved before ballot questions are certified in August, when the council traditionally recesses.

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Worried about risk, R.I. pension fund managers mull conservative investment approach

The managers of Rhode Island's $7.5-billion pension system Wednesday laid the groundwork to bolster the fund against more low or volatile investment returns, a move that could result in increased pension costs to taxpayers in the short term.

In a rare joint meeting, State Investment Commission and Retirement Board members Wednesday expressed concern that the pension fund won't make its assumed 7.5-percent annual investment return or might be exposed to unacceptable risks or wild market swings.

General Treasurer Seth Magaziner, who called the meeting in advance of reviewing of the pension system's investments this fall, said the comments pointed toward a more conservative investment strategy going forward.

While Magaziner stopped short of saying the state should lower its assumed rate of return, with the state and municipalities making up the difference, a more conservative investment strategy would reduce the chances of large gains.

"In general we know we have to be a little more risk averse than your average public pension plan," Magaziner said, noting the Rhode Island fund's current unfunded liability and negative cash flow. "We are going to come out of this process with an asset allocation that is designed to offer us protection in the event of another recession."

After the Investment Commission evaluates its investment strategy in September, the Retirement Board is slated to review the rate of return early next year.

Investment Commission member Sylvia Maxfield, dean of Providence College School of Business, told the board she didn't think the relatively steady, high investment returns of the 1960s, '70s and '80s are coming back.

"We have a series of structural changes in the global economy and the U.S. economy that are absolutely fundamental," Maxfield said. "Can we stomach anything other than low risk... If you can't, you've got to pay today."

"This rudderless boat is drifting toward inevitability," said Retirement Board member Dan Beardsley, executive director of the Rhode Island League of Cities and Towns. "The inevitability is we cannot sustain the rate of return that we have. The rate is going to have to be lowered."

On the other side, Retirement Board member Paul Dion, chief of the Office of Revenue Analysis, said the experience of the 2008 recession and past year of lackluster returns could be making the state overly pessimistic.

"We may be overemphasizing recent events," Dion said.

As of May, the most recent month figures were available, the pension fund posted a 1.97-percent loss over the last year and 5.34-percent gain over five years.

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EMPLOYER CONTRIBUTIONS TO STATE PENSION PLANS:

National Association of State Retirement Administrators has issued a brief on state and local government contributions to statewide pension plans for fiscal year 2014. Funding a pension plan takes place over many years and typically involves a combination of contributions from employees and employers, which are invested to generate investment earnings.

Contributions are a vital source of public pension funding: of the $6.7 trillion in public pension revenue since 1985, more than one-third has come from contributions paid by employers and employees. The amount of contributions needed to a fund pension plan is calculated as part of an actuarial valuation, which is a mathematical process that determines a pension plan's condition and required cost. Professional actuaries are guided by Actuarial Standards of Practice; ASOP No. 4 provides guidance on the determination of the required cost of a pension plan. Most public pension plans have an actuarial valuation conducted annually.

An actuarially determined contribution, or ADC, reflects the sum of a) the normal cost (the estimated cost of benefits earned each year); and b) the annual cost to amortize, or pay off over a designated period of time, the unfunded liability, which is the value of benefits earned to-date but for which assets have not yet been set aside. An ADC is affected by the many factors on which it is based, including actuarial methods and assumptions. Thus, as investment return assumptions, actuarial cost methods, mortality assumptions, amortization periods, etc. differ from one plan to another, the ADC also will vary. As a result, the ADC for two hypothetical plans with identical financial and demographic compositions could differ.

Pension plans typically maintain a funding policy by which they expect to reach full funding

at the end of a specified period of time if (a) the plan receives all of its actuarially determined contributions; and (b) all of the plan's actuarial assumptions -- about the many factors affecting the plan, such as future investment performance, how long plan participants will work, etc. materialize as expected. Experience rarely matches assumptions, so pension plans regularly monitor, typically through actuarial valuation and periodic actuarial experience studies, the plan's condition and make needed adjustments to actuarial assumptions and required contribution rates to reflect the changes in experience.

Laws and rules governing pension contributions vary widely among states and cities, and those provisions can affect public pension plan funding. The median actuarially determined contribution received in FY 14 was 100%, and ranged from 18% to 174%. On a dollar-weighted basis, the average ADC received was approximately 87%; the non-weighted average was 93%, as a few larger plans received a low portion of their ADC, reducing the weighted average. FY 14 marks the highest contribution experience since the market decline of 2008-09 increased unfunded pension liabilities and the economic recession diminished state and local fiscal conditions. The increase in required contributions, from FY 13 to FY 14 was 4.3%, marking the smallest annual increase in required contributions for the measurement period. This is likely a result of multiple factors, including strong investment returns following the 2008-09 market decline, and pension reforms, including higher required employee contributions and lower benefit levels (and costs) enacted in nearly every state since 2010.

The employer contribution experience since FY 2001 covers an eventful period, including two economic recessions and two sharp market downturns that reduced pension plan assets. As a result, actuarially determined contributions rose considerably while state and local government revenues were diminished or grew more slowly. For statewide plans, actuarially determined contributions rose from $27.8 billion in FY 01 to $98.2 billion in FY 14. Despite tepid fiscal conditions experienced by many states and cities, actual contributions paid by employers during this period grew from $28.1 billion to $85.6 billion, an increase of 204%. (Despite this increase, spending on pensions by states & local government remains around 4% of all spending.)

Because each state is unique in terms of its governance structure, the relative cost of its pension plans, fiscal condition, and other factors, so is the required contribution experience of each state also unique and ranges widely. On a weighted average basis, states' contribution record since FY 2001 varies, from less than 40% to more than 100%. In the median, state plans received 95.9% of their required contributions, and 84.6% as a weighted average. The average actuarially determined contribution received for the period was 89%, as a few larger plans received a lower portion of their ADCs. Although contributions to public pensions remain on average a small percentage of state and local

government spending, they also have grown in recent years.

Depending on the plan, the growth of required employer contributions is due to one or more of various factors, including investment market losses, insufficient contributions in prior years, revised actuarial methods and assumptions, and experience that differs from assumptions. The overall experience for FY 14, however, reflects an improved effort among state and local government employers to make the full actuarially determined contribution, which will forestall higher costs in the future and strengthen the long-term sustainability of public pension plans. (July 2016.)

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Private Sector

Maryland Enacts Mandatory Private-Sector Retirement Program That Impacts Most Maryland Employers

Maryland joins California, Connecticut, Illinois, and Oregon in leading state initiatives to set up state-sponsored retirement plans for employees. The Maryland Small Business Retirement Savings Program and Trust (“Program”), which is effective on July 1, 2016, requires covered private-sector employers to participate in the Program. Covered employers will be required to remit employee payroll contributions into an IRA, and the State will act as the Program’s fiduciary.

An 11-member board (“the Board”) will implement and administer the Program. Although the Program takes effect on July 1, 2016, it may not be implemented until the Board determines that the Program qualifies for favorable tax treatment under the Internal Revenue Code and that it is exempt from the provisions of the federal Employee Retirement Income Security Act of 1974 (“ERISA”). In that regard, in November 2015, the U. S. Department of Labor proposed a rule (RIN: 1210-AB71), entitled “Savings Arrangements Established by States for Non-Governmental Employees” (“the Rule”). The Rule proposes to set forth a safe harbor under which a state could establish a payroll deduction savings program without giving rise to an employee benefit plan under ERISA, and it appears that the Rule may take effect in or around September 2016. As such, employers may not have to comply until sometime after the final Rule takes effect.

Covered and Participating Employers

The definition of “covered employer” under the Program is broad. All non-governmental for-profit and nonprofit employers that pay their employees through a payroll system or service are covered under the Program. Accordingly, although the Program ostensibly was enacted to cover small businesses, it may impact almost every employer in Maryland. A “participating employer” is defined as a “covered employer” that provides a payroll deposit retirement savings arrangement under the Program for its covered employees.

An employer is exempted from participation if it: (1) currently offers an employer-sponsored savings arrangement; (2) offered an employer-sponsored plan within preceding two calendar years; or (3) has not been in business during the current and preceding calendar years. The Program provides that an employee of a non-participating employer may elect to participate in the Program as authorized by the Board. Although the language of the law it not clear, this may mean that employers who already maintain a retirement savings plan, or who are otherwise non-participating employers, may be required to participate if an employee elects to participate in the Program.

Rather than participate in the Program, covered employers may elect to establish alternative savings arrangement for their employees. An employer's participation in the Program, however, does not create a fiduciary liability for the employer. Specifically employers are not liable for employees' decisions to participate or to opt out of the Program, or for employees' investment decisions. Further employers are not responsible for program design, administration, investment, or performance.

Covered Employees

Generally, "covered employees" are employees without access to an employer-sponsored retirement plan who are at least 18 years old. Employees who are exempted from coverage are employees: (1) who are eligible to participate in an employer-sponsored plan and (2) who are covered by a collective bargaining agreement that expressly provides for a multiemployer retirement plan, and employees under age 18. Although not expressly stated in the law, the definition of "covered employee" suggests that those employees who do not yet have access to their employer's retirement plan due to, for example, service and/or hours eligibility requirements, may be eligible to participate in the Program.

Employee Contributions and Automatic Enrollment

After the Board establishes the Program and opens it for enrollment, covered employers must establish a payroll deposit savings program that allows for employee participation in the Program. Employers will be required to automatically enroll covered employees in the Program. The Program will consist of one or more payroll deposit IRA arrangements.

Unless employees indicate otherwise, they must contribute a default fixed percentage or dollar amount to be determined by the Board. Employers will be responsible for remitting employee contributions pursuant to regulations and/or procedures that the Board will establish. Employees may opt out of the Program in accordance with procedures that will be established by the Board.

Role of the Board

The Board must act solely in the interest of the program participants, and establish a written investment policy that includes a risk management and oversight program. The Board must also enter into an agreement delegating the administration of the Program to a third-party administrator.

Additionally, the Board must adopt regulations and take any other action necessary to

implement the Program consistent with the federal Internal Revenue Code and ensure that the program meets the criteria for tax-deferral or tax-exempt status, or both. The Program establishes additional requirements and authority related to the Board's administration of the Program, including without limitation:

•the authority to borrow funds from the State or any other entity for start-up costs until the board becomes self-sufficient;

•a requirement to establish a range of investment options, including a default option, that minimize the risk of significant investment losses and that are consistent with other specifications in the bill;

•a requirement to establish minimum and maximum employee contribution levels in accordance with federal limits on IRAs;

•a requirement to take any action necessary to ensure that the program is not preempted by federal law;

•a requirement to establish procedures and disclosures to protect the interests of participants and employers; and

•a requirement to design and disseminate information regarding the program to employers and employees. The information must include appropriate background and disclosures about the program and other retirement savings options, including information on how employees can opt out of the program.

Employer Incentives

Employers that participate in the program or otherwise offer an employer-sponsored retirement plan are exempted from Maryland's annual filing fee collected by the State Department of Assessments and Taxation for corporations and business entities, which is generally $300 per year.

As noted above, another incentive for employers is that they are not fiduciaries under the Program. The Program expressly provides that "an employer is not a fiduciary, and may not be considered to be a fiduciary" of the Program. Further, an employer may not be held liable for: (1) an employee's decision to participate in or opt out of the program; (2) the investment decisions of employees; (3) the administration, investment, or investment performance of the Program; or (4) the Program design or benefits paid to participating employees.

Although much is yet to be done before the Program takes effect, one thing is clear: Maryland employers will be required to sponsor their own retirement plan or automatically enroll their employees into the Program. Notably, the Program does not contain any penalties for employers who fail to comply, nor does it suggest that the Board would be authorized to impose such penalties

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Society of Actuaries Survey Examines Retirement Concerns and Managing Risks

Inflation and paying for long-term care top the list of concerns for retirees and individuals nearing retirement, according to the Society of Actuaries (SOA). These findings are from the SOA "2015 Risks and Process of Retirement Survey," which provides insights on how Americans decide to retire and manage resources in retirement.

Pre-retirees are most concerned about long-term care and inflation in retirement (both 69 percent) followed by paying for health care (67 percent). The survey report defines pre-retirees as individuals 45 and older who are not yet retired. Retirees had the same concerns, but at different amounts; 58 percent for long-term care, 52 percent for inflation and 47 percent for paying for health care.

"There is still a disconnect between what people think they will do in retirement to manage risks, compared to what approaches retirees actually used," said actuary Cindy Levering, ASA, MAAA. To manage financial risks, nearly 70 percent of pre-retirees expect to work in retirement and 46 percent plan to delay retirement. However, just 30 percent of retirees worked in retirement and 12 percent tried to postpone retirement.

As seen in the 2013 SOA survey, pre-retirees continue to underestimate life expectancy. For the 2015 survey, a median of pre-retirees predict they will live to age 85; however, 55 percent of pre-retirees said at least one family member lived past age 90. Personal life expectancy is ten years shorter than the age of their longest-living relative, according to 37 percent of pre-retirees and 28 percent of retirees.

"More than half of pre-retirees and retirees estimated their personal life expectancy well below actuarial estimates," said actuary Anna Rappaport, FSA, MAAA, and Chair of the SOA's Committee on Post-Retirement Needs and Risks. In terms of risk pooling strategies, only a third of pre-retirees (33 percent) purchased or plan to purchase a guaranteed lifetime income product. Twenty-two percent of retirees purchased this type of product. "The gaps in planning are worse than indicated by this data as few people try to plan for the long term. The most common type of planning is based on relatively short-term expected income and expenses, such as less than five years," Rappaport noted.

The survey findings include:

•In terms of experiencing financial shocks, the most common shocks for retirees are home repairs (23 percent), major dental expenses (24 percent) and medical/prescription expenses (20 percent).

•In terms of a planning horizon, 17 percent of pre-retirees plan for five to nine years, and 19 percent plan for ten to 14 years. By comparison, 38 percent of pre-retirees have either not thought about their planning horizon or do not plan ahead.
•The leading forms of debt for pre-retirees are mortgages (52 percent of pre-retirees), credit card debt (48 percent) and car loans (40 percent).
•Nearly 30 percent of pre-retirees had $30,000 of debt, excluding their mortgage debt. By comparison, 52 percent of retirees had less than $10,000 of debt.

In addition to this survey, the SOA also released a qualitative report on focus groups in the U.S. and Canada. The focus groups studied individuals who had been retired for at least 15 years. They provided valuable insights about the experience and expectations of the retirees, how they planned and the impact of shocks on the retirees. Read more about the focus groups research.

About the Report
Developed by Mathew Greenwald & Associates on behalf of the SOA, "2015 Risks and Process of Retirement Survey" is the eighth survey series since 2001. The report results were developed from an online survey of 2,000 Americans aged 45 to 80, of which half were retirees and the other half were pre-retirees. The survey was conducted in July 2015. Harnessing this survey research, the SOA will release retirement short reports in 2016 on shocks, spending and longevity.
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IRS Modifies Determination Letter Program for Individually Designed Plans

Internal Revenue Service (IRS) Revenue Procedure 2016-37 sets forth determination letter procedures for individually designed plans and the six-year remedial amendment cycle system for pre-approved plans.

The revenue procedure:

•Eliminates as of January 1, 2017, the five-year remedial amendment cycle system for individually designed plans. Effective January 1, 2017, a plan sponsor may submit a determination letter application only for initial plan qualification, for qualification upon plan termination, and in certain other circumstances.

•Provides an extended remedial amendment period under § 401(b) of the Internal Revenue

Code (Code) for individually designed plans.

•Describes and clarifies the six-year remedial amendment cycle system for pre-approved qualified plans and modifies the six-year remedial amendment cycle system to reflect changes to the individually designed plan determination letter program. It also delays until August 1, 2017, the beginning of the 12-month submission period for master and prototype (M&P) plan sponsors and volume submitter (VS) practitioners to submit pre-approved defined contribution plans for opinion or advisory letters during the third six-year remedial amendment cycle.

•Establishes an extended remedial amendment period for individually designed plans and the six-year remedial amendment cycle system for pre-approved plans.

Consideration will be given annually to whether determination letter applications will be accepted in circumstances other than for initial qualification and upon plan termination. Additional situations for determination letter requests will be published in the Internal Revenue Bulletin. Treasury and the IRS intend to periodically request comments on additional situations in which the submission of a determination letter application may be appropriate.

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The Effect of “Brexit” on Tax-Qualified Plans

The decision by British voters in a June 23, 2016 referendum to leave the European Union has significantly affected both the equity and debt segments of international financial markets. As with other market dislocations, the decision has also affected US tax-qualified plans, since they invest in those markets as a source of funding and use corporate bond rates for a variety of derivative purposes. The effects differ, however, between defined benefit (DB) and defined contribution (DC) plans.

Potential Effects of Brexit on DB Plans

In the case of DB plans, Brexit potentially has implications for funding levels, lump sum payments, Pension Benefit Guaranty Corporation (PBGC) premiums, and financial accounting results—all of which are the responsibility of the plan sponsor (rather than participants).

Specifically, the vote has triggered a decline in interest rates—including corporate bond rates—that may have at least a short-term adverse effect on the funded status of many DB plans, since (i) corporate bond rates are the proxy used to determine the present value of

liabilities for minimum funding purposes, and (ii) a decrease in rates triggers an increase in liabilities (present value inversely goes up as interest rates go down).

This effect will be mitigated somewhat, however, since DB plans generally can use a 25-year average of interest rates (with a 90% floor) for funding purposes, which tends to “smooth out” periodic spikes like Brexit. Still, if interest rates (which are already at historically low levels) decline further or continue to be depressed by the aftershocks of Brexit, more headwinds for DB plans seeking to improve their funded status will be created.

By contrast, DB plans must use a market rate of interest—that is, without “smoothing”—for lump sum, PBGC variable premium, and financial accounting purposes. As a result, any downward trajectory of interest rates triggered by Brexit will more directly affect DB plans for these three purposes. Thus, for example, the dollar amount of lump sums paid to employees will increase as rates fall (that is, lump sum present values grow inversely to interest rates).

This effect on the calculation of lump sum payments may be delayed somewhat, since most plans use a “look back” date for the related interest rates (such as the rate in effect two months before the start of the plan year in which the lump sum was paid). Nevertheless, if interest rates stay low or decline, these lower rates ultimately will roll into effect for lump sum calculation purposes. Plan sponsors that are otherwise so inclined may view this as an impetus to offer lump sum windows or annuity buyouts—sooner rather than later (and before any lower interest rates roll into effect). This is especially true of annuity buyouts, since insurance companies tend to use rates for premium calculations that are even more conservative (i.e., lower) than the corporate bond rates used under ERISA.

Similarly, the PBGC variable rate premium is essentially determined using the same rate as is used for lump sums, but without a lag. This will increase the liabilities that form the basis for determining the amount of the variable premium.

Finally, the use of spot fixed income rates for financial accounting purposes will have an adverse effect on a company’s balance sheet to the extent they trigger an increase in reportable plan liabilities. The impact will be much more pronounced than is the case with minimum funding considerations, since the use of spot rates does not allow the impact of currently falling rates to be offset by the prior year increases used in a “smoothing” approach.

Potential Effects of Brexit on DC Plans

In the case of DC plans, participants generally bear the primary risk (and reward) of their

investment choices, as allowed by ERISA Section 404(c). Thus, they will bear the risk of both declining bond prices and more volatile financial markets generally. Plan fiduciaries may want to consider alerting participants to the issues raised by Brexit, the possible impact on plan investments, the advisability of staying the course in turbulent markets, diversification considerations, and any other Brexit-related issues relevant to participation in the DC plan, but should be careful to avoid providing specific investment recommendations or advice that may be subject to ERISA's fiduciary obligations.

Conclusion

In the case of both DB and DC plans, the fiduciary responsible for selecting investments (such as an investment committee) should continue to monitor developments in the financial markets and react as appropriate, in light of the plan's investment policy statement and the general fiduciary requirements of ERISA. Federal courts and the US Department of Labor have consistently stated that ERISA fiduciaries are not held to a standard of omniscience, but they are required to exercise "procedural prudence" in selecting and monitoring plan investments. This sort of prudence would include adhering to the processes and other mandates established in the fiduciary's charter or other governing document.

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Moody's: Multiemployer pensions remain substantially underfunded, stressing sponsors, agencies

US multiemployer pension plans (MEPPs) remain substantially underfunded, threatening the viability of the Pension Benefit Guaranty Corporation's (PBGC) insurance fund and potentially putting a financial strain on company sponsors, says Moody's Investors Service.

In an analysis of 124 MEPPs, Moody's found that the plans were underfunded by a combined $337 billion at the end of 2014. That equates to an average funding ratio, a measure of the value of the assets in a pension plan against its obligations, of about 47%. The funding levels likely deteriorated further in 2015, given that year's anemic stock market and fixed income returns.

"It's simple mathematics," said Wesley Smyth, a Vice President and Senior Accounting Analyst at Moody's. "When a plan is only half funded, the assets have to work twice as hard to keep up with obligations."

The PBGC's Multiemployer Plan Insurance Fund, which insures the pension benefits of workers and retirees who work for private-sector employers, is in a critical condition. The

fund had $54 billion dollars in liabilities and only $2 billion in assets at the end of fiscal 2015, and the PBGC estimates there is a greater than 50% chance that it will be insolvent by 2025.

The pressure on MEPPs is compounded by an ageing demographic, according to the report "Multiemployer Pension Funding Levels Stressing Sponsors and Federal Agencies."

Moody's estimates that of the among its sample of MEPPs, the number of active participants is almost identical to the number of participants currently receiving benefits.

Some MEPPs have asked for government approval to cut benefits to try and resolve the issue of their unsustainable funding levels. If approved, these cuts would be credit positive for company sponsors of the plans.

Moody's believes that speculative grade companies which would struggle to meet any increase in pension funding costs are at the greatest risk of rating downgrades. However, companies with higher ratings could also face increased financial pressure should the underfunding persist.

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