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

Hogan proposes 401(k)-style retirement savings plan for Md. state employees

Maryland Gov. Larry Hogan (R) on Monday proposed legislation to allow state employees to pay into a 401(k)-style retirement plan instead of the state's public-pension system, sparking immediate criticism from unions that represent the workers. The plan would give future state employees the option of participating in a "defined contribution" program in which they and the state would each contribute an amount equal to 5 percent of pay toward individual retirement accounts.

Those who did would not be part of the state's public-pension program, which provides guaranteed payouts at levels that depend on length of service and other factors. All state workers currently pay into that system, but only those who have worked with the government for at least 10 years are entitled to benefits from it.

Employees who are currently working for the state would not be allowed to participate in the 401(k)-style program under Hogan's legislation, because of Internal Revenue Service regulations that govern transfers of retirement savings between plans.

Hogan excluded teachers from the proposal because the teachers union has strongly opposed such changes to the retirement system for its members, a spokeswoman for the governor said.

Public-employee unions said the proposal would reduce funding for the pension system and leave participants in the proposed 401(k)-style program vulnerable to stock market volatility.

Patrick Moran, president of AFSCME Maryland Council 3, the largest labor union representing state workers, called Hogan's legislation "an awful idea," saying it would "destabilize" the pension system.

Sen. Guy J. Guzzone (D-Howard), who co-chairs the legislature's joint committee on pensions, expressed skepticism that the majority-Democratic legislature would advance the measure but said his panel would give it "the courtesy of a careful review."

“Any kind of changes like this could have significant impacts on existing plans, existing employees and retired employees,” Guzzone said. “We’ll have to get our actuaries to do a complete analysis of it.”

Guzzone also noted that the state already offers its employees a 401(k)-style retirement benefit as an optional supplement to the public-pension plan.

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Despite risks, public pensions put faith in long-term returns

U.S. public pension funds are cutting their expectations for investment returns over the next 30 years or more, but some do not expect to meet even the new targets over the coming decade.

After a long period of low interest rates, forecasts by investment analysts show the next 10 years will probably bring slower market growth, leading to reduced expectations for the $3.7 trillion of public pension assets.

But public pensions are wary of lowering their expected return rates, or the discount rate, too quickly because doing so would drastically increase costs for state and local governments and their employees, whose contributions form the funds.

Instead, the funds say they plan to make up for lower returns expected in the coming decade over the next 30 years or more.

"Pension funds are in an extraordinarily difficult political situation," said Don Boyd, fiscal studies director at the Rockefeller Institute of Government.

If they protect their portfolios by moving assets into safer, lower-return investments, he said, "they will have to drastically increase the cost for local governments. They are reluctant to do that."

The California Public Employees' Retirement System, the largest U.S. public pension fund, anticipates annual returns of 6.2 percent over the next decade.

However, CalPERS still expects its long-term return to align more closely with a discount rate that it plans to reduce to 7 percent by 2020, because it anticipates returns will jump to 7.83 percent in the decades to follow.

Such a forecast in the short term could spell declining fund conditions, a rise in unfunded liabilities and increased costs for government employers and workers.

CalPERS is not alone. The Ohio Public Employees Retirement System expects an average 6.76 percent return over the next five to seven years, short of its 7.5 percent discount rate. But the fund anticipates returns will climb to 7.85 percent over a 30-year period.

Los Angeles Fire and Police Pensions expects compound returns of 6.33 percent over the next decade, considerably below its 7.5 percent discount rate. The fund believes the compound return "will rise over the long-term as interest rates move back up," said General Manager Ray Ciranna.

PAST IS PROLOGUE

Private-sector and public plans in Canada and Europe lowered their discount rates over the past two decades. But U.S. public pension funds maintained higher return expectations and put more of their money in risky assets to help achieve them, according to the Rockefeller Institute. As a result, the potential impact of investment shortfalls, relative to government tax revenue, is now more than three times as large as it was in 1995, and about 10 times as large in 1985, the Rockefeller Institute found.

CalPERS hopes to avoid another calamity like the one it experienced during the 2008 recession, when its funding status dropped to 61 percent from 100 percent.

Like the vast majority of U.S. public pensions, the $307 billion fund is now paying out more money to retirees than it is collecting from current workers and employers.

"It's a challenging market to operate in," said CalPERS Chief Investment Officer Ted Eliopoulos. "When you're in that position, you need to be asymmetrically concerned about downside risk as upside risk."

CalPERS has reduced volatile stocks and private equity from its portfolio. It made more than $9.2 billion in net equity sales in September and October, according to fund documents. In December, the board reduced the discount rate to reflect the new portfolio allocation.

The new expectations still did not reflect investment advisers' short-term forecasts. Wilshire estimated only a 17 percent probability that CalPERS would earn its new 7 percent discount rate over the next decade.

At the time, CalPERS board member J.J. Jelincic proposed reducing expectations further to align the discount rate more closely with advisers' forecasts. "6.25 is the reality," Jelincic said at a December meeting.

But the board worried that the costs of such a move would require even higher contributions from California governments and workers.

Cities are already warning of the impending strain.

Scotts Valley, a small city outside of Santa Cruz, expects its annual pension costs to jump by nearly 75 percent over three years under CalPERS' new discount rate. By 2021, the city's annual pension contributions will reach $2.8 million, about 16.3 percent of the city's total budget, up from $1.5 million, or 9.6 percent, today.

"Even though I personally would like to see a lower assumption," CalPERS board member Dana Hollinger said in December, "I realize it would be too much of a strain on budgets."
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Connecticut governor asks towns to contribute toward teacher pension costs

Connecticut Gov. Dannel P. Malloy is asking towns to contribute to the costs of their teachers' pensions as part of his proposed 2018/2019 fiscal year biennial budget presented to the state Legislature on Wednesday.

Currently, the state pays 100% of the employer contribution to the $15.8 billion Teachers' Retirement System. The governor's proposed budget asks the municipalities where they work to contribute a third of those costs. This year, the state government is set to contribute $1.2 billion.

The teachers pension fund "has always been funded without any contribution from towns or cities. My budget does not propose that we demolish that system or shift the entire costs to towns," Mr. Malloy said when presenting his proposed budget at the state capital. "But this year … we need towns to begin sharing the cost of their employees' pensions."

Mr. Malloy added: "As such, my budget asks our towns and cities — all of them — to contribute one-third of the cost toward their teacher pensions."

In addition, the proposed budget stays below its $18 billion spending cap and grows at a pace well below inflation, while making the required increase in contributions — more than $357 million — to the state's pension systems in the first year.
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Michigan governor eyes lower assumed investment rate for pensions

Michigan Governor Rick Snyder on Wednesday unveiled a plan to drop the assumed rate of investment return for the state's retirement funds to 7.5 percent from the current 8 percent. The Republican governor said the change would be significant but prudent.

"We want to be conservative in making sure we have those resources for the people that earned those pensions and benefits," Snyder told a joint House and Senate appropriations committee as part of his fiscal 2018 budget presentation.

He added that further reductions in the rate were possible if merited. Under the plan, the reduced rate for funds covering state workers, police, judges, and the national guard, would be immediate upon adoption by the state budget director and the retirement systems' boards. A lower rate for the Michigan Public School Employees' Retirement System would be phased in over two years.

The move would trigger increased pension payments by Michigan of an additional nearly $247 million in fiscal 2018, which begins Oct. 1, and $400 million in fiscal 2019, according to budget documents.

Snyder proposed a $56.3 billion all-funds budget, which includes $10.1 billion for operations and $12.3 billion for primary and secondary public schools.

On Monday, he announced a task force to formulate proposals by this spring for Michigan's local government pensions and retiree healthcare. The total unfunded liability for healthcare is about $10 billion and the total unfunded pension liability is estimated at $4 billion for hundreds of local governments units that offer these benefits, according to Snyder's office.
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Dallas Police and Fire Pension Backs Cutbacks to Avoid Collapse

The Dallas Police and Fire Pension is getting behind a Texas lawmaker’s plan to save the retirement system from financial collapse.

The fund’s board voted 9-0 on Monday to back a proposal by Dan Flynn, chair of the pensions committee in the state’s House of Representatives, that would raise the retirement age to 58 from 55, eliminate cost-of-living adjustments and lower a multiplier used to determine the size of officers' and firefighters' benefit checks, according to a summary on the pension's website.

The plan would also increase Dallas's annual contribution to 34.5 percent of payroll plus $11 million per year. The city contributed 27 percent in 2015, according to audited financial statements. Employee contributions would climb to 13.5 percent of their pay from 8.5 percent.

The $7 billion shortfall in the police and fire pension triggered downgrades to Dallas's credit rating from Moody's Investors Service and S&P Global Ratings. The system was battered by losses on exotic investments including Hawaiian villas, Uruguayan timber and undeveloped land in Arizona. The pension, which counted on annual investment returns of 8.5 percent to cover promised benefits, had an average 1.5 percent loss over the past five years, according to S&P.

Despite the poor returns, the city's annual contribution is capped by state law, limiting its ability to boost contributions to make up for the investment losses.

As the fund's financial health deteriorated, retirees concerned about its solvency and potential benefit cuts pulled more than $500 million in the last five months of 2016. The withdrawals were made from a program that allows employees to reinvest their pensions if they remain on the job after they're eligible to retire, while earning 8 percent to 10 percent interest. In December, the pension suspended the withdrawals. Flynn's plan would roll back the program.

The police officers and firefighters supported Flynn's plan over one proposed by Mayor Mike Rawlings that would take back the interest payments.

The vote "is consistent with our efforts and doesn't change anything for those of us working to save the system," Rawlings said in a statement. "As we've said from the very beginning, all parties will have to share in the pain as we meet this challenge."

Flynn is still working on legislation that would enact his plan, according to a spokeswoman who declined to comment on the pension fund's vote.

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Private Sector

CFP Board, other fiduciary advocates prep for fight to save DoL rule

Anticipating the Trump administration could derail the Department of Labor's contentious fiduciary rule, groups like the CFP Board are adopting a defensive strategy: focus on preserving investor protections from the previous administration, rather than championing new regulations.

"Top of the list here is of course supporting and defending the DoL fiduciary rule," says Maureen Thompson, the CFP Board's vice president of public policy.

The DoL's fiduciary rule is widely expected to be a target of the Trump administration, which in early activity has taken steps to curtail regulations it deems harmful to business and economic growth.

Despite the rule already being on the books with an initial compliance date of April 10, there was industry speculation Wednesday morning the White House was readying an executive order to delay it.

Multiple sources who have been involved in the debate over the regulation say they understand that an executive order delaying the rule is under consideration, though the timing remains unclear.

A White House spokesman did not immediately respond to a request for comment on any potential executive order.

One source suggested that the White House might hold off on the order, waiting to see if President Trump's pick to head the Labor Department, Andy Puzder, wins Senate approval. His confirmation hearings have been delayed several times thus far as the nominee compiles his ethics disclosure paperwork.

Sources say that any White House action would likely direct the Labor Department to delay implementation of the fiduciary rule for a period of time — likely six months — while the various legal challenges to the regulation work their way through court. At that time, the DoL could then reopen the matter for a notice-and-comment period, after which it could determine whether to revise or repeal the rule altogether.

'CAN'T TOSS OUT RULE'

However, some experts observe that, since the rule is already on the books, amending or repealing the rule will initiate a new series of procedural hurdles.

"[D]oing so will likely take additional rulemaking because the rule was actually enacted — as opposed to simply stating the rule is dead — which will take additional comment periods," says Brendan McGarry, an attorney with the law firm Kaufman Dolowich & Voluck, who represents RIAs and other financial professionals in litigation and regulatory affairs.

"You can't just say we're tossing out this rule," the CFP Board's Thompson says.

But whether a White House order comes out this week, next month or not at all, investor-protection advocates are girding for a fight to preserve the fiduciary rule either at the Labor Department or on Capitol Hill. Already in the new congress, Rep. Joe Wilson (R-S.C.) has introduced legislation that would impose a two-year delay on implementing the DoL rule.

Thompson says she anticipates that Rep. Ann Wagner (R-Mo.) could revive legislation she backed in the last Congress that would direct the Labor Department to delay its rule until the SEC completed its own work on a separate fiduciary rulemaking — a distant prospect at a five-person agency with two empty commissioner seats and an as-yet unconfirmed chairman who, once in office, is not expected to race toward new rulemakings.

"Our concern is that a delay would effectively kill the rule," Thompson says.

A spokeswoman for Wagner did not respond to messages seeking comment on plans to revive the Retail Investor Protection Act, which passed the House in 2015 but stalled in the Senate.

WHAT'S PRUDENT

For now, the fiduciary rule is the law of the land, and with the first implementation date fast approaching, advisers, brokers and others covered by the regulation have been retooling their compliance programs, and, in the case of the many firms that have been revisiting how they handle commission-based retirement accounts, upending their business practices.

"What we've been telling members is, unless and until it's actually delayed, the prudent thing to do would be to treat it as if it's going into effect," says Bob Grohowski, general counsel at the Investment Adviser Association.

"Our concern is that a delay would effectively kill the rule."

Thompson and other advocates are planning to make support of the DoL rule a centerpiece of their advocacy on Capitol Hill, where they will be shopping around a message that the early evidence suggests that financial services firms have been absorbing the fiduciary regulation and have not generally been cutting services or hiking fees.

"I think we do have a good story to tell," Thompson says.

Barbara Roper, director of investor protection at the Consumer Federation of America, agreed. "Costs of both investment products and investment advice are dropping, the toxic incentives that encourage and reward harmful advice are being eliminated, and small savers are getting more choice — not less — about how to pay for advice," she says. "All thanks to changes firms are making to comply with the rule."
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Taking Phased Retirement Options to the Next Level

Employees may think ad hoc approaches are arbitrary or even discriminatory

Employers have long developed ad hoc arrangements with some older workers who, approaching the end of their careers, are looking to phase into retirement instead of making an abrupt break. These arrangements benefited both parties, allowing employers to ensure adequate knowledge transfer and letting these employees smooth their transition to full-time retirement.

Less clear is whether employers are willing to make such arrangements more widely available to workers throughout their organizations. A study of 14,400 active and 1,600 retired employees conducted by Transamerica's Aegon Center for Longevity and Retirement found that:

55 percent of employees age 55 and older want to retire gradually.

Only 27 percent say that their employers offer the ability to wind down by shifting to part-time work as they age.

Trying Out a Company-Wide Program

Amazon is testing alternative work arrangements organization-wide with retirement-age employees. The company started the program last year with a pilot including a small group of employees working in HR. These employees will work certain baseline hours from 10 a.m. to 2 p.m. Monday through Thursday that can be supplemented with additional flexible hours to reach a required 30 hours per week. The company will adjust employees' salaries to reflect the lower number of hours worked.

"Once certain companies do this, others may start to think through where this approach might work for various employee groups who want a reduced schedule," said Jackie Breslin, director of human capital services with TriNet, a HR consulting firm in San Francisco." Employers that want to emulate this approach can begin by analyzing each department to see which ones could accommodate a 30-hour or other reduced work week.

"If companies can demonstrate that they can attract and retain high-level workers who want part-time hours, this could be a creative way to retain employees who otherwise would be looking at retirement," she noted.

Formalizing the Ad Hoc

The risk of ad hoc arrangements occurs when they are seen as arbitrary or potentially discriminatory by offering something to favored employees but not to others.

To avoid such legal exposure, employers can create parameters for these arrangements by, for instance:

Adopting clearly articulated criteria for eligibility, such as tenure or position in the company.

Determining and communicating how any reduction in work hours will impact pay and eligibility for employee benefits, including health insurance, vacation time, retirement plans, paid holidays and so on.

It is also a good idea to have an end date at which point the employee retires fully. Otherwise, the employee may like the arrangement so much that they try to extend it indefinitely.

To avoid this problem, "it is a good idea to have the employee submit a letter of resignation that is post-dated to the end of the agreement," said Louis Rabaut, a partner with law firm Warner, Norcross and Judd in Grand Rapids, Mich. "HR can detail how duties will end and how power will be transferred to others over the phased retirement period."

Do They Keep Their Benefits?

Part-time work could reduce make workers ineligible for employer-paid health insurance, which is especially of concern for retiring workers who do not qualify for Medicare. Given Congress and President Trump's intention to repeal the Affordable Care Act (ACA), it is uncertain how phased-retirement employees would get health insurance and how expensive that might be.

"It is unlikely that any ACA repeal will dismantle the ability of someone who is less than 65 to be able to purchase health insurance," said Joseph DiBella, managing director and executive vice president of employee benefits at consultancy Conner Strong & Buckelew in Philadelphia. However, the options available to these retirees could be expensive and come with extremely high deductibles.

For that reason, employers that are interested in offering phased retirement programs may need to provide education about and access to health savings accounts (HSAs) during employees' working years, when employees can build a health care nest egg to help them afford pre-Medicare health policies (if retiring under age 65) or "Medigap" policies that supplement Medicare (if they're over age 65).

"Further health care reform or ACA repeal could force active employees to think long and hard about how to better use their HSAs as an investment vehicle to fund their retirement," DiBella said.

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Wilshire TUCS, Northern Trust report gains above 7% in 2016 for investment plan universes

Institutional investors gained more than 7% in 2016, said data released Tuesday by Wilshire Associates and Northern Trust.

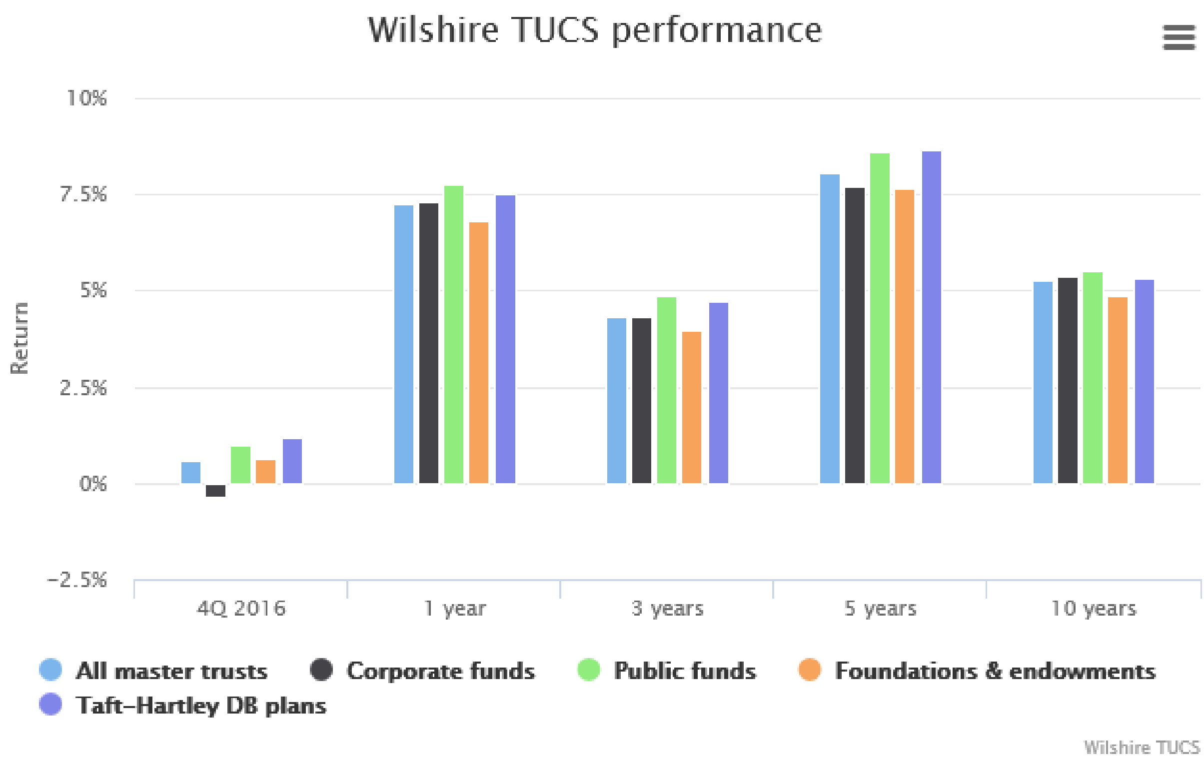
Plans in the Wilshire Trust Universe Comparison Service returned a median 0.59% and 7.24% over the three and 12 months ended Dec. 31, compared to 3.19% for the quarter ended Sept. 30 and -0.17% for the year ended Dec. 31, 2015.

While the 7.24% return for 2016 marks the highest annual median return in three years, 2016 marks the fourth consecutive year for which the median plan type underperformed the classic 60% equity/40% bonds portfolio, which returned 10.29%. It is also the sixth consecutive quarter for which the median plan type underperformed the classic 60/40 portfolio, which returned 1.59% in the fourth quarter.

Boosted by a larger allocation to U.S. equities (median 48.3%), Taft-Hartley defined benefit plans were the top-performing plan type for the quarter with a return of 1.21%, followed by public DB plans at 0.98%; endowments and foundations, 0.64%; and Taft-Hartley health and welfare funds, 0.59%, said Robert J. Waid, managing director at Wilshire Associates, in a telephone interview.

Dragged down by a larger allocation to U.S. bonds (median 35.1%), corporate funds were the worst-performing plan type in the fourth quarter, returning, -0.37%.

Public DB plans were the top-performing plan type for the year, returning 7.77%, followed by Taft-Hartley DB plans at 7.53%; corporate plans, 7.31%; foundations and endowments, 6.8%; and Taft-Hartley health and welfare funds, 5.42%.



Over the three and 12 months ended Dec. 31, the Wilshire 5000 Total Market index returned 4.54% and 13.37%, respectively, surpassing the MSCI World ACWI ex-U.S. which returned -1.25% and 4.5% over those same periods.

Other market returns were as follows: Wilshire Bond index at -2.83% for the quarter and 5.67% for the year; Bloomberg Barclays Global Aggregate, -2.34% and 3.95%; and Wilshire Global Real

Estate Securities index, -3.88% and 5.79%.

Broken out by plan size, large public plans (assets greater than $1 billion) posted an even higher median return of 7.92% for the year. These large public plans are typically more diversified into some of the subasset classes like small-cap equity, which did well in 2016, Mr. Waid said. Emerging markets equity, international equities and high-yield bonds also did pretty well in 2016, Mr. Waid said.

Longer term, for the three, five and 10 years ended Dec. 31, the TUCS universe returned a median annualized 4.32%, 8.06%, and 5.28%, respectively.

Wilshire TUCS includes more than 1,200 plans with more than $3.6 trillion in assets.

Meanwhile, institutional asset owners in the Northern Trust Universe returned a median 0.5% and 7.4% in the three months and 12 months ended Dec. 31, compared to 3.6% for the quarter ended Sept. 30 and -0.62% for the year ended Dec. 31, 2015.

Foundations and endowments were the highest-performing plan type for the quarter, returning 1%, followed by public DB plans at 0.8% and corporate DB plans, -0.8%.

Corporate plans were the highest-returning plan type for the year, returning 8.2%, followed by public funds at 7.9% and foundations and endowments, 6.6%.

In the fourth quarter, public pension funds were helped by their roughly 37% allocation to U.S. equities, which had the highest asset class return for the quarter at 4.2%, while corporate plans were hurt by a larger allocation to non-core fixed income, which declined nearly 6%, said Amy Garrigues, head of investment risk and analytical services as Northern Trust, in a news release on the results.

Among the other asset classes, the universe had a median international equity return of -1.7% for the quarter; total fixed income, -2.4%; U.S. fixed income, -2.4%; and international fixed income, -2.9%.

For the year, the universe had a median U.S. equity return of 12%; international equity, 4.7%; total fixed income, 5.6%; U.S. fixed income, 4.7%; and international fixed income, 4.5%.

The Northern Trust universe tracks about 300 large U.S. institutional plans with combined assets of $899 billion.

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U.S. House puts brakes on Philly plans to aid small businesses with retirement savings

Congress effectively put the brakes on a plan by the city of Philadelphia that would have allowed small businesses to set up retirement-savings plans for their workers.

Two votes by the House of Representatives Wednesday afternoon rolled back changes in U.S Labor Department regulations involving worker retirement plans. For months, relying on the changes, the City Controller's Office has been working on a plan that would have allowed small businesses to set up retirement-savings plans for their workers.

The votes were 231-193 on one measure and 234-191 on a related measure, along party lines, with Republicans voting to roll back the regulations.

"It's callous," City Controller Alan Butkovitz said in an interview Wednesday. Philadelphia had been one of three cities exploring city-administered retirement-savings plans for small businesses that didn't have the time or the expertise to set up plans for their employees.

Butkovitz had joined New York City's comptroller and the chairman of the Seattle City Council's finance committee in a letter urging the legislators to vote "no" on the two resolutions, H.J. Res. 66 and H.J. Res. 67.

The regulations had permitted states and municipalities to devise retirement systems. Philadelphia had been at the forefront, one of a handful of cities nationwide to contemplate establishing a retirement system for business owners and their employees.

"How can anyone be against this?" Butkovitz asked.

The U.S. Chamber of Commerce wrote a similar letter, with the opposite point of view, urging Congress members to roll back the changes.

Allowing states and municipalities to create their own plans would set up a confusing array of regulations, wrote Jack Howard, senior vice president for governmental affairs for the chamber. "It would be particularly problematic for companies with operations spanning state boundaries."

Howard added workers' savings would not be as well-protected as they have been under federal law.

Butkovitz said some opposition from business might result because some of the proposed state and city plans might require businesses to participate. The plan contemplated in Philadelphia was strictly voluntary, however.

"Nearly 55 million workers across the country lack access to employer-sponsored retirement plans, and millions more fail to take full advantage of employer-supported plans," Butkovitz and the others wrote in a letter to House Speaker Paul Ryan, a Republican.

"States across the country have been innovating to address this problem," the letter said, adding, "Thirty states and municipalities are in the process of implementing or exploring the establishment of state-facilitated, private-sector retirement programs."

Although the details were not finalized and several approaches were under consideration, the idea in Philadelphia was to create what would amount to a city government-administered plug-and-play system for small employers who have neither the money nor the expertise to create retirement plans for their employees.

Here's how it would have worked: Employers would instruct their payroll companies to set up another deduction, a simple step. Employees would contribute. Employer contribution would be optional and would depend on the type of plan to be set up.

The hard parts — figuring out who should invest the money collected and administering the accounts with monthly statements and tax forms — would have been handled by the city, either through the same services it uses to manage and administer the municipal retirement-savings accounts or by putting the project out for bid to a big investment firm, such as Vanguard or Prudential.

The City Controller's Office had sponsored meetings for businesses around the city, with people like Nancy Morozin, owner of the Dining Car diner in Northeast Philadelphia, in attendance. Morozin said she applauded an idea that would help her help 100 employees save for retirement.

Butkovitz said a City Council task force had been looking into the plan.

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PBGC Adds Credit Deterioration, Cash-Flow Decline to Early Warning Factors It Monitors

The U.S. Pension Benefit Guaranty Corp. (PBGC) has added two more conditions to the list of early warning factors that it watches and believes may endanger the funding of single-employer defined benefit (DB) retirement plans.

The federal pension insurance agency has for more than 20 years monitored corporate transactions and events through its Early Warning Program (EWP). In December 2016, the PBGC updated the program's overview on its website and added "credit deterioration" and a "downward trend in cash flow or other financial factors" to its watch list.

Existing Watch List

The EWP already included the following factors in its early warning signs for company DB plans:

- A change in the group of companies legally responsible for supporting a pension plan (known as a controlled group), including a spin-off of a subsidiary;
- A transfer of significantly underfunded pension liabilities related to the sale of a business;
- A major divestiture by an employer that retains significantly underfunded pension liabilities;
- A leveraged buyout involving the purchase of a company using a large amount of secured debt; or
- The payment of a very large dividend to shareholders.

The agency said its experience has shown that it can avoid terminating a pension plan by working with the plan sponsor to obtain protections before a business transaction significantly increases the risk of loss.

The new additions may lead to a PBGC inquiry, even if none of the other corporate transaction warning signs listed is present. "There are also concerns that these factors may result in more forcefully sought financial concessions from companies that can ill afford them," said Human Resources consulting firm Willis Towers Watson in a February 1 client bulletin.

Previous guidance from the PBGC indicated that it focused on "financially troubled" companies but that the agency would not act on that basis alone.

The PBGC website said it identifies about 300 transactions, events, or trends each year that are potentially of concern and engages the plan sponsors to obtain additional information. It assesses the impact of these situations based on each employer's financial and operational ability to support its pension promises. It then may follow the initial inquiry with a more in-depth review, amounting to an average of about 100 cases each year.

In recent years, of the 300 initial transactions or events, the PBGC said it entered into an average of five settlements each year, or less than 2% of identified events.

Underfunding Leads to Restrictions

Under the Pension Protection Act of 2006, benefit restrictions apply when a DB plan becomes underfunded to certain prescribed levels. Specifically, various benefit restrictions apply when a DB plan's adjusted funding target attainment percentage — or AFTAP — is under 80% (defined as at-risk plans).

The AFTAP is based on a plan's funding target attainment percentage, or FTAP. The FTAP is the ratio of the value of net plan assets for the plan year, reduced by prefunding and carryover balances, to the plan's funding target for the plan year, as defined in Code Section 430(d).

The AFTAP is the FTAP, adjusted by adding to the plan's assets and funding target the value of any annuities purchased for nonhighly compensated employees during the previous two plan years. (See ¶361 in the Pension Plan Fix-It Handbook for more on this topic.)

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