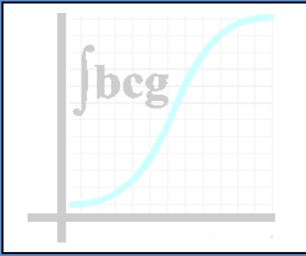

BCG Retirement News Roundup

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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.

Inside This Issue

Public Sector/Government Plans

- How Refinancing Debt Can Help Pensions
- Public Pensions and the Assets That Could Sustain Them
- How PSERS Pa. Teachers' pension fund beat market indexes in 2016
- CalPERS Forced to Declare Southern California Agency in Default of Pension Obligations
- Governor’s plan to shift pension funding gives pause to local officials

Private Sector

- FASB changes presentation of defined benefit costs
- Fed Rate Hike Isn’t Big News for Pension Plans, Yet
- Lump sum de-risking in 2017
- Options for Social Security
- Cash Balance Challenge Defeated By Bank of America

Public Sector/Government Plans

How Refinancing Debt Can Help Pensions

North Carolina wants to use existing low rates to shore up retiree pensions and health-care debt.

In the low interest rate environment, states and localities have been saving billions by refinancing old debt. In most cases, the savings have benefited the general fund balance. But in North Carolina, State Treasurer Dale Folwell is making a push to instead use those savings to pay down pension and retiree health-care debt.

Starting this spring, Folwell plans to refinance “every dollar we possibly can.” He'll ask the General Assembly to divert the savings to the treasurer’s office, where he'll then divvy up the extra dollars: 15 percent goes into the pension fund and 85 percent goes toward retiree health-care debt, which has a larger unfunded liability.

The approach has garnered rave reviews, but some question just how big a dent any such savings can make in an unfunded liability that in North Carolina totals nearly $38 billion between retiree pensions and health care.

It’s true the money can add up. Since 2009, North Carolina has refinanced roughly $4 billion in debt, amounting to savings of nearly $289 million, according to the state’s most recent debt affordability study.

Nationwide, more than half of the total bonds issued in the municipal market since 2009 have been to refinance deals. Last year, roughly $275 billion of the nearly $450 billion in total bond issuance was to refinance existing debt. Refinancing deals are still expected to drive issuance this year, even with the Federal Reserve slated to raise short-term interest rates.

The savings per deal can vary. Connecticut saved nearly $76 million last year when it refinanced $501 million in general obligation bonds. In 2015, Washington state refinanced $421 million and saved $32 million in debt costs.

Municipal bond expert Matt Fabian also notes that savings from refinancing debt aren't immediate. Similar to refinancing a home, the debtor makes lower payments on the debt going forward, meaning the total savings are realized over time. For instance,

Connecticut in 2014 refinanced $822 million in general obligation bonds and saved $94.8 million over the next 11 years.“So the savings are real but it’s on paper,” says Fabian, a partner at Municipal Market Analytics. “In effect, it’s a promise to pay [over time] from the general fund the savings they just generated.”

Still, Fabian praises North Carolina because refinancing essentially produces “found” money. “Any time you can start paying down a debt without raising taxes or cutting spending, that’s a good thing,” agrees Donald Boyd, director of fiscal studies at the Nelson A. Rockefeller Institute of Government. He adds that it’s also better fiscal policy to put found money into a one-time use, rather than into recurring expenses like the current year’s budget.

Folwell thinks that credit ratings agencies will look favorably upon the tactic. North Carolina already has a top AAA rating, but he thinks that by urging local governments to follow the state’s lead, it will strengthen their credit ratings as well. “If you take a portion -- if not all – of those interest savings and put it toward another liability,” says Folwell, “it is a win-win in the eyes of the community, the state and the rating agency.”
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Public Pensions and the Assets That Could Sustain Them

Transferring public assets or the revenue they generate may be an idea whose time has come.

For decades, when cash was scarce, corporate pension-plan sponsors have made in-kind contributions -- non-cash assets such as securities and real estate -- to fund their retirement plans. US Steel, for example, contributed 170,000 acres of timberland to meet its pension liabilities. General Motors used securities from a subsidiary company. Facing bankruptcy, Pan American World Airways transferred the lease for its flagship terminal at New York's Kennedy Airport to its pension funds. These private-sector plan sponsors looked to their balance sheets for assets they could monetize by contributing them to their pension funds.

Given the fiscal struggles that so many state and local governments face, it might seem that the idea of funding public retirement systems with cash-generating public assets or dedicated funding streams from them would be one that would have caught on long ago. It's an idea that, done properly, is worth considering. Yet state and local policymakers have only recently begun to follow the lead of corporate America. Most recently, New Jersey Gov. Chris Christie cited the private sector's practice of transferring assets to pension funds when he proposed funding his state's beleaguered public pension plans with revenues from the state's lottery.

The governor maintained that the strategy would immediately reduce the pension system's current unfunded liability (which is based on the actuarial assumptions for the fund), increase its funded ratio (a measure of its assets' market value), and lower the amount the state would have to pay into the system in coming years. He reckoned this would please taxpayers, bond investors, credit-rating agencies and public employees alike.

How this might be done is still to be worked out, but the notion of a pension plan generating income from a lottery asset is not new. In Canada, the Ontario Teachers' Pension Plan owns the licenses to operate both the British and Irish national lotteries. These assets were not in-kind contributions but rather a direct investment aimed at boosting the pension fund's returns.

The difference between a pension fund buying an asset and receiving one in lieu of cash is important. The former is like a marriage for love, while the latter is more akin to an arranged marriage with a dowry of uncompensated risks. An asset such as a state lottery is also much harder to value than stocks or bonds, less readily sold and much more complex to manage. Pension trustees might rightly suggest that policymakers just sell the asset.

Another complicating factor is that many pension funds are not authorized to own assets directly or to operate businesses. They can, however, acquire businesses that operate commercial assets. The British and Irish lotteries, for example, are managed by the Camelot Group, an operating company owned by the Ontario teachers' pension.

Yet there is a case to be made for in-kind contributions when the risks and rewards can be structured fairly and understood clearly by all parties. For governments, an in-kind contribution can make use of a surplus asset in a way that preserves precious cash, improves balance-sheet resiliency and avoids service cuts or tax increases -- all the while keeping a civic asset in the public sector. For pension plans, an in-kind contribution presents an opportunity to obtain an asset without acquisition costs.

It can also be argued that pension funds are better suited to managing certain assets than government agencies are. Gov. Christie suggested this in his proposal by acknowledging that the state government does not have the ability to tap into the significant value of a special asset like the state lottery. Case in point: The UK National Lottery has made record profits under the Ontario pension's management.

The in-kind contribution being proposed in New Jersey may eventually end up resembling one executed by Pittsburgh in 2010, when the City Council irrevocably dedicated parking revenues to the city's three employee pension funds for 31 years. The city effectively

transferred the value of asset ownership to the pension plan without requiring it to assume the risks of ownership or management responsibilities. This past February, Fitch Ratings rewarded the city by raising its credit rating, citing Pittsburgh's ongoing plan to improve pension funding.

Both Pittsburgh's in-kind contribution and the one being proposed for New Jersey involve income-producing assets. In contrast, Hartford, Conn.'s Municipal Employees Retirement Fund is being asked to accept a 600-acre public park -- which does not currently produce revenue for the city -- as partial payment of the city's annual required contribution. This potentially puts the fund in a difficult position. Its options include selling a local civic asset, commercializing the land or accepting a reduced annual contribution.

Clearly, in-kind contributions are not a silver bullet for state and local governments or for public pension funds. It is hard to identify assets suitable for this funding mechanism and even more difficult to price and structure them fairly. But they may be worth the trouble and serious consideration. One of the most profitable in-kind contributions made to a pension fund was the conveyance in 2011 of a toll-road network owned by Australia's Queensland state government to the state's pension fund. Queensland Investment Corporation, the fund's savvy manager, restructured the business, added two additional roads to the toll network and sold the asset three years later at a $3.8 billion profit for the pension fund. Bottom line: Pension fund wins are wins for taxpayers too.
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How PSERS Pa. Teachers' pension fund beat market indexes in 2016

PSERS, the $50 billion+ Pennsylvania Public School Employees' Retirement System, says it posted 2016 calendar-year returns of 10.7%, as its mix of energy, real estate, private, stock and bond investments outperformed both its 7.25% long-term annual target, and other large area pension systems. See PSERS' brief year-end investment report here.

"All major asset classes PSERS invested in generated positive returns," chief investment officer James H. Grossman Jr. said in a statement. "Energy Master Limited Partnerships, U.S. Equities, Risk Parity, and Commodities were the best performing asset classes in 2016."
By comparison, Philadelphia's pension plan returned 6.7 percent, the Pennsylvania State Employees' Retirement System returned 6.5 percent, and Montgomery County, which in 2013 fired its investment managers and put most of the fund into Vanguard index funds, returned 7.5 percent.

PSERS' outperformance reversed last year's results, when it trailed the other plans -- again

due in part to its energy investments, which lagged that year as oil prices tumbled.

PSERS also said it returned 5.75 percent, annualized, for the past three years, and 7.43 percent over the five-year period ended December 31, 2016, meeting its long-term 7.25% target, which PSERS says it has also exceeded over the past 25 years.

Looking ahead, Grossman concluded: "We remain optimistic about the current fiscal year. If the markets continue to do well, PSERS appears on track to beat its earnings assumption of 7.25 percent for the current fiscal year which ends June 30th. PSERS asset allocation is performing as expected, generating good returns while prudently controlling investment risk."

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CalPERS Forced to Declare Southern California Agency in Default of Pension Obligations

East San Gabriel Valley Human Services consortium failed to fund pension benefits it promised its employees

The California Public Employees' Retirement System (CalPERS) Board of Administration today declared the East San Gabriel Valley Human Services consortium in default and terminated its contract after it failed to pay more than $400,000 to fund its pension plan.

Under the law, pension benefits will be reduced by approximately 63 percent for 191 members and 24 percent for six members hired after pension reform went into effect in 2013, effective July 1, 2017 if the consortium fails to pay.

"The Board was forced to make this painful decision after East San Gabriel Valley failed to stand by its contractual obligations despite repeated and numerous attempts by CalPERS to avoid this terrible situation," said Rob Feckner, president of the CalPERS Board. "Cutting benefits to retirees is truly the last step we want to take, but our employers must uphold their obligations and keep the promises that they made to their employees. We have a fiduciary responsibility to protect the long-term future of all beneficiaries and the fund."

East San Gabriel Valley is a Joint Powers Authority consortium formed in 1979 by the cities of West Covina, Covina, Azusa, and Glendora to primarily provide employment and training services to local residents and inmates incarcerated by the Los Angeles County Sheriff's Department.

The consortium lost a major contract and closed its headquarters in 2014. Since August

2015 it has failed to pay its Unfunded Accrued Liability (UAL), now totaling $406,345. CalPERS made multiple attempts to collect the outstanding amount due, including:

- Holding discussions with consortium officials in over 34 telephone calls
- Sending multiple collection and demand notices to the consortium
- Contacting all four of the cities that formed the consortium 38 years ago to request immediate payment

California Public Employees' Retirement Law allows the Board to terminate an agency contract after it fails for 30 days to pay the full amount owed in contributions. The law also requires retirement benefits be reduced by the proportion of the amount due in accumulated employer and member contributions.

The terminated contract will take effect in 60 days. Once the contract is terminated, the consortium is liable to pay the full amount of its termination liability of approximately $19.3 million, which would fully fund current and future payments of retirement benefits to its members. If the consortium fails to pay the termination liability, then CalPERS will send a notice to current and former employees of the consortium outlining the decision to reduce retirement benefits, beginning July 1, 2017.

CalPERS first notified employees and retirees in January 2017 that the consortium had failed to pay the amount due and that retirement benefit reductions could follow. The reduction applies only to the portion of benefits a member earned while working at the consortium.

"Our financial oversight of public agencies will continue to further reduce the risks to members, employers, and the CalPERS Fund," said Richard Costigan, chair of the CalPERS Finance & Administration Committee. "We're committed to being a reliable partner to our participating employers and helping them fully understand the costs of the pension benefits they offer."

One of the consortium's four founding cities contends that it cannot pay the pension contributions because doing so would constitute a "gift of public funds." CalPERS General Counsel Matthew Jacobs disagreed, and said that public entities have a legal right to appropriate funds as they see fit, as long as it's for a public purpose, such as paying public pension contributions.

Last November, CalPERS declared the city of Loyalton in default of its obligations to CalPERS after failing to pay what it owes to fund its pension plan, and reduced benefits for four Loyalton retirees.

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Governor's plan to shift pension funding gives pause to local officials

First Selectman Jayme Stevenson was in Hartford testifying against proposed legislation for the second time in a week last Thursday.

Stevenson spoke out against H.B. 7050 — An act concerning enhancements to municipal finance and responsibility — in front of the state's Revenue, Finance and Bonding Committee on March 9. She was in Hartford just two days earlier opposing a bill that would force municipalities to form regional health departments.

In early February, Malloy proposed a two-year $40 billion budget that cut state aid to all but 31 of the state's 169 towns and cities. The municipal finance bill would shift one-third of the burden of paying for teacher's pensions from the state-run Teachers' Retirement Fund to individual municipalities. In Darien's case, the bill would mean a $4.5 million contributed from the town in Fiscal Year 2017-2018.

Currently, the state pays 100 percent of the employer pension costs.

"While the bill's language defines the proposed municipal contribution as a "reimbursement to the state" the objective is clear...to bail out the state's chronic, decades-long, bi-partisan underfunding and mismanagement of the Teachers' Retirement Fund," Stevenson said in her prepared statement. "This proposal is inconsistent with state statute, breaks the state's statutory commitment to our hard working teachers and undermines the fiscal stability of towns like Darien who pride ourselves on conservative spending, investment and reserves policies earning us the highest available bond rating."

As a punishment for its fiscal responsibility, Stevenson said, Darien would be strapped with a roughly $8 million bill from the state, including other state cuts, which would put undue responsibility on residents.

"Without gutting town services, the likely impact will be the third largest tax increase in the state's history as a result of these state mandates," Stevenson said.

Stevenson also invoked the Connecticut Coalition for Justice in Education Funding (CCJEF) v. Jodi Rell case, which is currently in the Connecticut Supreme Court with a late summer decision anticipated, in which the CCJEF alleged that the state's inability to equally fund its public schools harmed students.

In New Canaan, the town would find itself owing $4.1 million should the legislation be

passed.

While First Selectman Robert Mallozzi III said the state's plans to cut funding are a "game changer," he and the Board of Finance in New Canaan see it as more of a problem for next budget season, as opposed to the current Fiscal Year 2017-2018 budget.

"There's a long legal challenge ahead. There's more to come before the state can assign to us any fiduciary responsibility," Mallozzi said.

Still, he said that increased uncertainty at the state level has had an impact on the ways in which towns are approaching their budgets.

"I think having this kind of uncertainty as towns are preparing their budgets gives a lot of pause to decision making. My guess is towns like New Canaan and others are not as aggressive in wanting to take on debt and increase their budgets because of the fiscal condition of the state," Mallozzi said.

The legislature will make recommendations by the end of April to close a projected $1.7 billion state deficit. The legislative session ends on June 7, and the governor's office would like to have a set budget by then.

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Private Sector

FASB changes presentation of defined benefit costs

FASB issued an accounting standard Friday that is designed to increase the transparency and usefulness of information about defined benefit costs for pension plans and other post-retirement benefit plans presented in employer financial statements.

The rules changes are described in Accounting Standards Update No. 2017-07, Compensation—Retirement Benefits (Topic 715): Improving the Presentation of Net Periodic Pension Cost and Net Periodic Postretirement Benefit Cost.

Defined benefit pension cost and post-retirement benefit cost (net benefit cost) comprise several components under GAAP that reflect different aspects of an employer's financial arrangements, as well as the cost of benefits provided to employees. GAAP requires those components to be aggregated for reporting in financial statements.

FASB made the changes because stakeholders said the presentation of defined benefit cost on a net basis combines elements that are heterogeneous. Therefore, the current presentation requirement was believed to lack transparency and limit usefulness of the financial information. The current requirement led users to incur greater costs in analyzing financial statements, stakeholders said.

To address those issues, the new standard requires a reporting organization to separate the service cost component from the other components of net benefit cost for presentation purposes.

The new standard also:

- Provides explicit guidance on how to present the service cost component and other components of the net benefit cost in the income statement.

- Allows only the service cost component of net benefit costs to be eligible for capitalization.

The standard takes effect for public business entities for annual periods beginning after Dec. 15, 2017, including interim periods within those annual periods. For other entities, the amendments take effect for annual periods beginning after Dec. 15, 2018, and interim

periods within annual periods beginning after Dec. 15, 2019. Early adoption is permitted, subject to certain conditions.
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Fed Rate Hike Isn't Big News for Pension Plans, Yet

The Federal Reserve Board's recent interest rate boost doesn't directly affect corporate pension plan funding, but plan sponsors may want to begin taking action.

The Fed's .25 percent increase to the federal funds rate directly affects short term interest rates, but not the long-term, high quality corporate bond rates that pension plans are sensitive to. In fact, long-term rates have dropped from about 4.25 percent to around 4.1 percent since the Fed began raising short-term rates in December 2015.

Long-term rates sometimes move in tandem with short-term rates and sponsors should continue to monitor them, John Lowell, pension consultant for October Three in Atlanta, told Bloomberg BNA March 16. Sponsors would be wise to construct models measuring the consequences to their plan's funding in anticipation of long-term rates rising by as much as 75 basis points (.75 percent), Lowell said.

The bump in rates has the "psychological effect of making people expect that interest rates will keep rising," but it's impossible to know whether rates will continue to do so, and if they do, by how much, Evan Inglis, a pension actuary in Vienna, Va., told Bloomberg BNA on March 17.

Rather than trying to anticipate when long-term rates will peak, plan sponsors should gradually move their plan asset portfolio into longer-term corporate bonds so they don't miss out on the higher yields these investments offer, Inglis said.

Matt McDaniel, a partner in Mercer's retirement practice in Philadelphia, agreed with Inglis. Sponsors that don't want to be in the "interest rate guessing game" can use the Fed's latest rate hike to spur them to employ de-risking strategies to replace their plan's stock investments with long-term bonds as interest rates rise and the plan's funding level improves, he told Bloomberg BNA March 16.

Rate Effect Unpredictable

Plan advisers agree that a rise in interest rates is generally good for plans because plan

liabilities decline as interest rates rise. However, rising rates can ultimately erode the value of plan assets by reducing both stock and bond prices.

There's also the question of whether the Fed's interest rate moves amount to a trend. Despite the fact that Federal Reserve Chairwoman Janet Yellen said she expects the Federal Open Market Committee to raise rates several more times this year, the fact that the bond market yield curve is not steeper shows that the market is skeptical, Inglis said. “We've seen rates go up before,” only to “fool the market” by coming back down, said Inglis, who was speaking on behalf of the American Academy of Actuaries.

Many economists don’t believe that economic growth will return to past levels anytime soon. This means the potential for inflation and rising interest rates may be overstated, Inglis said.

Even if inflation pressures are mounting, the Fed’s action in boosting rates could actually serve to bring long-term rates down. That’s because bond investors may see the Fed’s action as an effective measure to hold inflation in check, he said.

Given all the uncertainty, it’s understandable that plan sponsors may be confused about what action to take, if any.

Lowell said he would advise sponsors to model the effects of potential interest rate changes, which should include an analysis of the cost of borrowing and raising capital.

Lowell said he expects to see some some large insurers encouraging plans to transfer pension risks through annuity purchases and plan terminations. “As rates trend upwards, insurers have more reason to believe that this will be the time that many plans try to terminate and these insurers will want their fair share of this business,” he said.

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Lump sum de-risking in 2017

In this article we discuss how changes in interest rates, Pension Benefit Guaranty Corporation premiums and mortality tables may affect sponsor decisions to de-risk (or not de-risk) defined benefit plan liabilities in 2017. For purposes of this article, by de-risking we mean paying out a participant’s benefit as a lump sum and thereby eliminating the related liability – the ‘low-hanging fruit’ for pension de-risking efforts.

This is a technical article, but for some sponsors there may be significant dollars at stake.

Example

We are going to illustrate the effect of these developments on the de-risking decision with an example: the de-risking gain with respect to a terminated vested 50 year-old participant who is scheduled to receive a monthly life annuity of $100 beginning at age 65.

Summary

We begin with the bottom line. For our example participant, declines in interest rates have increased lump sums in 2017 vs. 2016 by 4%-20%, depending on the 'lookback month' used by the plan to determine lump sums. The wide range is due to the fact that rates moved up sharply from all-time lows in the second half of 2016.

For plans with an August lookback month, the increase is $1,439 (from $7,092 to $8,531), but for plans with a December lookback month, the increase is only $281 (from $7,026 to $7,307).

The savings from de-risking comes from reduced PBGC premiums and the avoidance of increased costs from the adoption of new mortality tables. Total savings depend on whether or not the plan is affected by the PBGC variable premium cap, as summarized in the following table:

Plan savings (present value) from de-risking example participant

PBGC flat-rate premiums	$2,070
New mortality tables	225
Total for plans not affected by variable premium cap	**$2,295**
PBGC variable-rate premiums (only applicable to plans subject to the variable-rate premium cap)	*2,950*
Total for plans affected by variable premium cap	**$5,245**

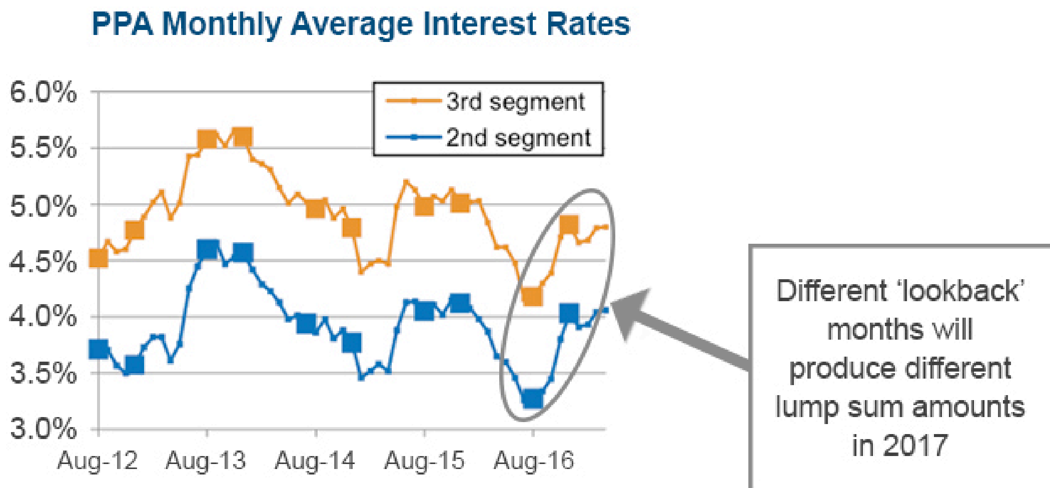
Thus, de-risking in 2017 still produces significant savings to plans, in the form of future premium and mortality savings worth 27%-72% of the total value of the example participant's lump sum.

Interest rates

De-risking involves paying out the present value of a participant's benefit as a lump sum.

The interest rates used to calculate that present value are the Pension Protection Act (PPA) 'spot' first, second and third segment rates for a designated month. Sponsors typically set the lump sum rate at the beginning of the plan year, based on a lookback month defined in the plan (August through December for calendar-year plans), so they will know what rate will be used to calculate their lump sum for the entire year.

The following chart shows PPA spot second and third segment rates for the period 2012-2016, with August and December lookback months highlighted:



As this data indicates, 2016 interest rates were generally lower than 2015 rates, particularly for plans with an August lookback month.

The following table shows the cost of a lump sum payment to our example participant for 2013-2017 for a sponsor using a prior year's November rates.

Cost of lump sum payment – monthly $100 deferred vested benefit beginning at age 65/participant is 50

2013	$7,759
2014	6,143
2015	7,177
2016	6,878
2017	7,550

So the effect of the change in interest rates has been to increase the cost of de-risking our example participant by $672 ($7,550 - $6,878) relative to 2016 for a plan with a November lookback month.

PBGC premiums

Reducing participant headcount, e.g., by paying out lump sums to terminated vested participants, reduces the PBGC flat-rate premium and may, depending on plan funding and demographics, reduce the variable-rate premium. Premiums for the current year are based on headcount for the prior year. So de-risking in 2017 will reduce premiums beginning in 2018.

PBGC flat-rate premiums

The PBGC flat-rate premium is $74 per participant for 2018; it increases to $80 in 2019 and is increased for (wage) inflation thereafter. Discounting annual premiums for 35 years (assuming the participant lives to age 85) yields a present value of $2,070.

Variable-rate premiums

In our article Reducing pension plan headcount reduces risk and PBGC premiums we discussed how de-risking can, in some cases, dramatically reduce the variable-rate premium. The logic of that is not especially intuitive. The gains come from the headcount-based cap on variable-rate premiums. In 2018 the headcount cap will be about $530 per participant. Oversimplifying, depending on plan funding and demographics, de-risking (that is, lump summing-out) one participant in 2017 may save a sponsor $530 per year in PBGC variable premiums beginning in 2018 (on top of headcount premium savings.)

As plan funding improves, however, this savings will go away. For purposes of our example we're going to assume the plan 'funds its way out' of the per participant variable-rate premium cap after 6 years. Discounting the annual variable premium cap for 6 years yields a present value of around $2,950.

For details on the effect of de-risking on the variable-rate premium, we refer you to our article.

Effect of new mortality tables

At the end of 2014 the Society of Actuaries finalized new mortality tables for private DB plans. While the SOA subsequently modified those tables in a way that will in most cases

somewhat reduce their impact, they generally will increase liability valuations.
IRS is expected to update the mortality tables that plans must, under the Tax Code and ERISA, use in calculating lump sums in 2018. The effect of the adoption of the new tables on lump sum valuations will depend on a number of factors, but generally they will increase lump sum valuations by about 3%.

For purposes of our example, if our 50 year old is paid a lump sum before the new tables are adopted, we assume (somewhat arbitrarily) the plan will avoid a 3% mortality assumption-driven increase in cost of about $225.

Note: we are characterizing payment of a lump sum before new mortality tables go into effect as producing a 'savings.' That savings, however, is different from the PBGC premium savings discussed above. It's possible to calculate the PBGC premium savings with some certainty. The gains from paying a lump sum before new mortality tables go into effect are more speculative and depend fundamentally on plan demographics and final IRS guidance.
Finally, sponsors may wish to consider whether, and how, to explain the effect of soon-to-be-adopted mortality tables on a participant's decision to take a lump sum, either as part of a de-risking transaction or simply in the course of an ordinary retirement.

Regulatory environment

With the election of President Trump, it's possible that concerns that some in the prior Administration expressed about de-risking may subside. For instance, because of Trump's policy of reducing regulation generally, IRS may not (as in July 2015 it said it intended to) amend current regulations to "provide that qualified defined benefit plans generally are not permitted to replace any joint and survivor, single life, or other annuity currently being paid with a lump sum payment or other accelerated form of distribution." (Notice 2015-49)

Declines in lump sum valuation interest rates have made de-risking in 2017 more expensive than it was in 2016. However, because of increased PBGC premiums, de-risking continues to produce substantial savings.

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Options for Social Security

While delivering testimony at Congressional hearings in February, CBO's Director was asked a number of questions about potential changes to Social Security. Because answers during hearings are inherently brief, this blog post provides some additional information.

What Are CBO's Projections for Social Security?

Social Security is the largest single program in the federal government's budget. CBO projects that the program's outlays will rise significantly over the coming decades—from 4.9 percent of gross domestic product (GDP) in 2017 to about 6.3 percent of GDP 30 years from now. Average benefits per recipient are expected to continue to increase at roughly the same rate as per capita GDP. However, a significantly larger portion of the population will begin to draw benefits because more of the baby-boom generation will reach retirement age. Their longer life spans will result in those beneficiaries' receiving payments for more years than was the case in the past, thus increasing the total amount of benefits the average retiree receives over a lifetime. Those factors will combine to cause the growth in benefits as scheduled under current law to outpace the growth in the economy overall.

Total revenues for the program, however, are anticipated to decline slightly in relation to the size of the economy, from 4.6 percent of GDP in 2017 to 4.5 percent of GDP 30 years from now. The decline is expected to occur because most of the program's receipts come from the payroll tax—a flat-rate assessment (up to a maximum amount per worker, which is indexed to average earnings)—and because the proportion of earnings subject to the payroll tax is expected to shrink.

What Are Some Options for Changing Social Security?

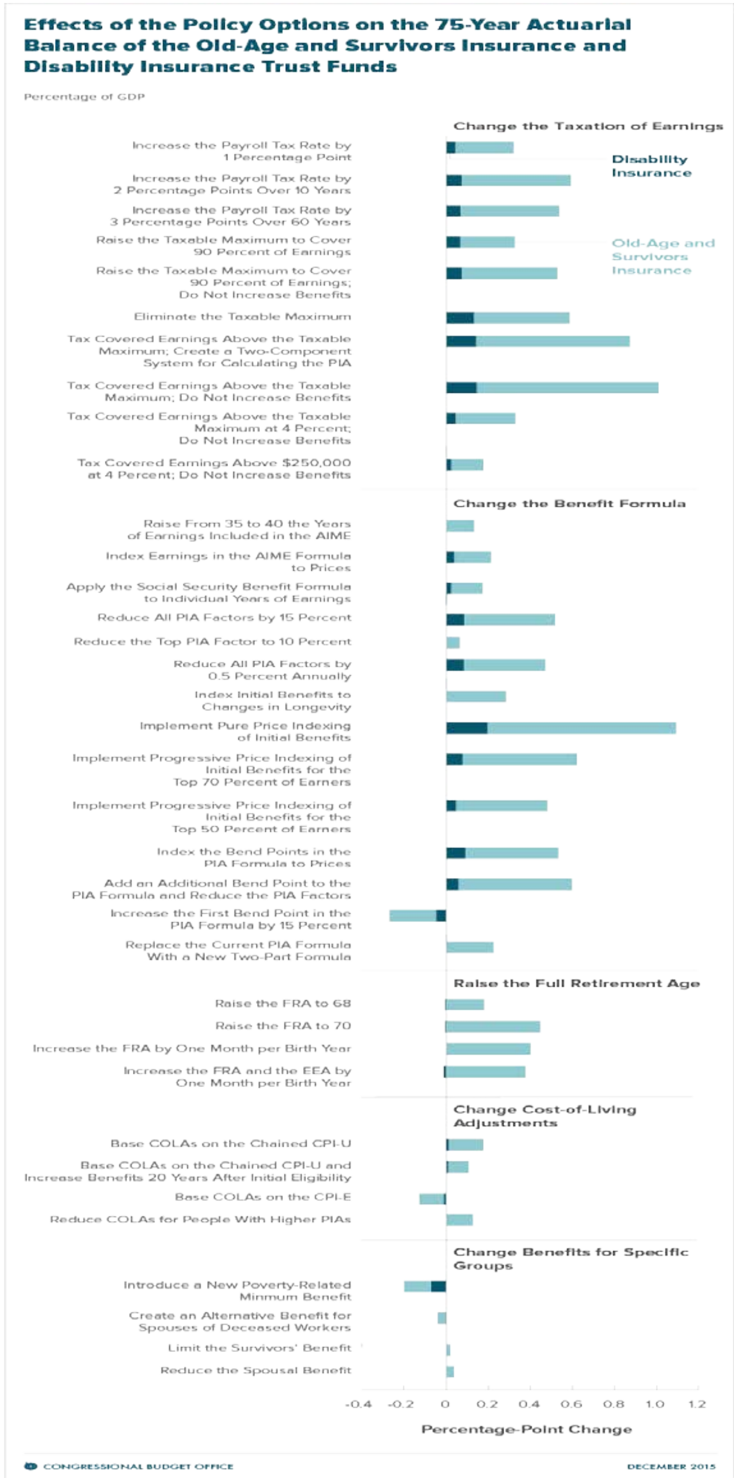
In a 2015 report, CBO considered 36 policy options that are among those commonly proposed by policymakers and analysts, divided into five groups according to the elements of the Social Security program that they would modify:

- The taxation of earnings,
- The benefit formula,
- The full retirement age,
- Cost-of-living adjustments, and
- Benefits for specific groups.

Although CBO has not updated its analysis of those options, the agency expects that updated estimates of the options' long-term effects would be broadly similar to those reported in 2015. For example, CBO reported that gradually increasing the payroll tax rate by 3 percentage points over 60 years would improve the 75-year actuarial balance by 0.5 percentage points of GDP, as would gradually reducing benefits by 15 percent for newly eligible beneficiaries over 10 years, starting in 2023; each of those options would eliminate about one-third of the shortfall in the program's finances. (The actuarial balance is the sum of the present value of projected tax revenues and the current trust fund balance minus the

sum of the present value of projected outlays and a year's worth of benefits at the end of a given period. A present value is a single number that expresses a flow of future income or payments in terms of an equivalent lump sum received or paid at a specific point in time.)

By itself, no individual option that CBO examined would create long-term stability for the Social Security program (see the figure below). Some options would affect all workers or beneficiaries similarly; others would have widely disparate effects, depending on a beneficiary's year of birth or lifetime earnings. The effects of many of the options could be changed if they were implemented at a larger or smaller scale or phased in more slowly or quickly, although the resulting effects would not necessarily be proportional to the results presented in the report. If the goal was to address Social Security's long-term imbalance, it would be necessary to combine several of the options that CBO analyzed. However, the effects of several policy changes implemented together are not always equal to the sum of the individual effects of those policy changes.



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Cash Balance Challenge Defeated By Bank of America

Plaintiffs originally filed their cash balance plan lawsuit in 2004, claiming the way their employer created a cash balance plan by essentially transforming an existing 401(k) represented impermissible benefit cutbacks.

An opinion handed down by The United States District Court for The Western District Of North Carolina, Charlotte Division, rules in favor of the defendant, Bank of American, which had been accused of profiting from imprudence and disloyalty in the management of a cash balance plan.

The case has had a lengthy and complicated procedural history, stretching back to a time before Bank of America even existed as such and calling out cash balance plan design/administration decisions made by then-NationsBank leadership. Most recently the case was revived and remanded by the 4th U.S. Circuit Court of Appeals, leading to the current decision.

Plaintiffs originally filed their cash balance plan lawsuit in 2004, claiming the way their employer created a cash balance plan by essentially transforming an existing 401(k) represented impermissible benefit cutbacks. After that, in 2005, an audit of the bank's plan by the Internal Revenue Service (IRS) resulted in a technical advice memorandum order, in which the IRS concluded that the transfers of 401(k) plan participants' assets to the cash balance plan between 1998 and 2001 violated relevant Internal Revenue Code provisions and Treasury regulations.

According to the IRS, the transfers impermissibly eliminated the 401(k) plan participants' "separate account feature," meaning that participants were no longer being credited with the actual gains and losses "generated by funds contributed on the participant[s'] behalf." The IRS determination led a federal district court to move the participants' case forward. However, the bank entered into a closing agreement with the IRS, paying a $10 million fine and setting up a special-purpose 401(k) plan to restore participants' accounts. The district court determined that, following the closing agreement, the participants no longer had standing to sue.

The appellate court then determined that the plaintiffs in fact had standing to sue under Employee Retirement Income Security Act (ERISA) Section 502(a)(3), which provides that a plan beneficiary may obtain "appropriate equitable relief" to redress "any act or practice which violates" ERISA provisions contained in a certain subchapter of the United States Code. The court found that the transfers violated ERISA's anti-cutback provisions, as determined by the Internal Revenue Service during a plan audit, and that

the relief the plaintiffs are seeking—the profits Bank of America made from the assets transferred—is “appropriate equitable relief.”

On remand, the current decision comes down in favor of Bank of America. The full text of the decision outlines substantial expert testimony and other evidence marshaled by both sides, arguing whether or not the company ultimately benefited or suffered from the way it managed the plans in question. Ultimately greater deference was shown to Bank of America’s arguments that it actually suffered greater financial losses, rather than undue profits, as a result of its improper behavior than it otherwise would have. This was in no small part due to the fact that the bank’s retirement plan investment returns were dramatically impacted by the Great Recession.

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