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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Kentucky pension reform bill would move future teachers into cash balance plan

A pension reform bill filed in the Kentucky Senate would enroll future teachers in a new cash balance plan and give other future and current workers the option of participating in a 401(a) plan. Under the bill filed by Republican Sen. Joe Bowen Tuesday, teachers hired after Jan. 1, 2019, would be enrolled in a cash balance plan instead of the existing defined benefit plan at the $18.1 billion Kentucky Teachers' Retirement System, Frankfort, according to bill documents. Cash balance plans would be maintained for other current and future employees that make up the separate $17.4 billion Kentucky Retirement Systems, Frankfort. However, current and future non-hazardous employees, excluding teachers, would have the option of participating in a new 401(a) defined contribution plan. Under the 401(a) plan, employers would contribute 4%.

Additionally, the bill reduces retired teachers' cost-of-living adjustments to 0.75% from 1.5% if the teachers' system is less than 90% funded as of the most recent actuarial valuation. The plan is currently less than 60% funded. For currently retired teachers, this applies to the period between July 1, 2019, and July 1, 2030. For future retired teachers, this applies up to 12 years after retirement.

The bill also calls for the formation of an advisory committee to study a separation or restructuring of KRS' underlying pension funds and present recommendations to the Public Pension Oversight Board by Dec. 1, 2019. The board helps the General Assembly with its analysis and oversight of the administration, funding, laws and regulations relating to the state retirement systems.

Tuesday's bill marks a significant departure from the reform recommendations released by Gov. Matt Bevin and Republican legislative leaders in October, which called for automatically moving some future workers and eventually some active workers into defined contribution plans, among other changes.

A news release from Mr. Bevin's office in October pegged total unfunded liabilities for KRS, KTRS and the $327 million Kentucky Judicial Form Retirement System, Frankfort, at $64 billion.

Half of Retirees Retired Earlier Than Planned, But Not Necessarily by Choice

More than half of retirees retired earlier than planned, but the vast majority did so in response to factors that were partially or fully out of their control, new research finds.

Prudential's "Planning Your Retirement? Expect the Unexpected" study finds that 51% of retirees retired earlier than planned. While that may seem like welcome news, only 23% did so because they had enough money to retire, wanted to retire or were tired of working.

The study shows that 46% of those who retired earlier than expected did so because of health problems; 30% were laid off or offered an early retirement incentive package; and 11% quit to take care of a family member.

Pre-retirees seem well aware of these risk factors, according to the report, as their responses to concerns that may affect their retirement closely mirrored the actual reasons that retirees cited that caused them to retire earlier than planned. When asked about their greatest concerns that could negatively affect retirement savings, three of the factors cited by pre-retirees could force an early retirement: illness or disability (43%), losing a job (35%), and taking care of a loved one (12%). Meanwhile, the research further shows that the gap between average actual and expected retirement ages was extensive. Pre-retiree respondents have a target retirement age of 65, but the mean actual retirement age for the retirees was 59. Most significantly, half of those who retired earlier than planned did so five or more years early.

The authors emphasize that this is especially important because the last several years of a career are generally considered to be top earning years and help boost the formulas that may drive retirement income, such as Social Security and DB pension income levels. In addition, unplanned early retirement can also accelerate the strain on financial resources because of the additional years in which retirement income is needed. And of course, some early retirees may not yet be eligible for Social Security or Medicare.

To quantify the effect of unplanned early retirement, the report cites a 2006 analysis by the Urban Institute showing that working an additional five years would result in a 56% increase in retirement income based on the incremental net wealth accumulated. This translates into a 36% reduction in total retirement income for individuals retiring five years early, the authors note.

The research further suggest that pre-retirees could benefit from a financial plan. Nearly three-quarters of pre-retiree respondents (74%) agree they should be doing more to prepare for retirement, but 40% say they "simply don't know what to do." In addition, more than half (54%) of

pre-retirees have less than $150,000 saved in their employer-sponsored plans.
The Retirement Preparedness Study was conducted by Harris Poll on behalf of Prudential between July 20 and Aug. 9, 2016, using an online survey among 1,568 adults (including 438 retirees).

California Cities' Pension Bills May Rise With Calpers Move

California cities may see their annual pension costs rise under a new policy from the state's retirement system, threatening to foist added financial pressure on those already struggling to pay for promises to public employees.

The California Public Employees' Retirement System is advancing a staff recommendation that would shorten the amortization period for new pension liabilities from 30 years to 20. That would boost the system's funded ratio, require localities to pay off the debt sooner and allow the pension to recover faster from market downturns, according to a staff report. Approved by a Calpers committee Tuesday, the full board is set to vote on the changes Wednesday.

The ramped up schedule, while positive for the solvency of the pension system by letting it book gains faster, would make market losses felt more swiftly by local governments and require them to pay more into the retirement fund in at least the first few years.

The shorter period reduces the possibility that the system, which currently has about 68 cents for every dollar in liabilities, falls below 50 percent funding, board member Bill Slaton said during the meeting.

"That is not a great position to be in," said Slaton. "All it takes is another movement or two, and we could find ourselves in a position where we cannot recover."
The shorter amortization period would be effective in June 2019 and would affect contributions by local governments in fiscal 2022.

While many cities would welcome paying off the debt more quickly to rack up less interest, others that are already struggling with high fixed costs would find it difficult to meet the stepped-up pace, said Dane Hutchings, lobbyist for the League of California Cities. And in the event of poor market performance, municipal contributions to make up the difference would be even higher than projected, compounding the burden.
Such an outcome, when combined with other pressure facing cities, could push a few into bankruptcy, Hutchings said. "It would be their death knell" for some, he said.
California municipalities are already absorbing the effect of the board's decision in December 2016 to lower the assumed rate of return to 7 percent from 7.50 percent by fiscal 2020, which will also

require them to increase their contributions to cover the gap.

The system's 3,000 cities, counties, school districts and other public agencies have also seen costs rise from several factors, including investment losses and perks granted in boom times. A report this month by the League of California Cities found that under current assumptions, cities in fiscal 2025 would pay Calpers more than 50 percent the amount expected to pay in fiscal 2019.

"Cities are struggling to keep up," Mike Futrell, city manager for South San Francisco, told the committee before the vote Tuesday in a request to delay changes. The municipality had already been considering whether to ask voters in November to approve a tax increase to help pay its obligations, he said.

Calpers's review comes as the system is likely to experience more market volatility in 2018 than it had over the past couple of years, Chief Investment Officer Ted Eliopoulos told the board Monday.

Meanwhile, the fund's 20-year return is lagging at 6.7 percent, according to a Calpers's estimate. A survey of 164 public pensions by the National Conference on Public Employee Retirement Systems, a trade association, showed that the average amortization period in 2017 was 23.8 years.

Participation in Retirement Plans Increases Focus on Financial Future

Workers who are participating or have participated in an employer-sponsored retirement plan are more likely to have calculated retirement income needs and to have used more sophisticated tools for doing so, Pew finds.

An analysis from Pew Charitable Trusts of data from a nationally representative internet survey of private-sector workers shows a correlation between access to and participation in workplace-based retirement savings programs and more planning and saving.

Overall, workers with access to an employer-sponsored retirement plan were much more likely to report that they had tried to figure out in the previous two years how much retirement income they would need (41%), compared to those with no access (16%). Past participation in a workplace savings program also is associated with a greater likelihood of retirement planning: among workers who do not currently participate, 30% of those who do not currently have access and 33% of those with access but who do not participate report planning for retirement. That's about twice as high as those who never participated, regardless of access.

Even when accounting for other worker characteristics, such as education, race/ethnicity, gender, household income, unemployment history, and age, those who have never participated in employer-sponsored retirement plans are much less likely to plan for retirement than those who have participated or are currently participating. During a media call, John Scott, director, The Pew Charitable Trusts' retirement savings project, said, "Most do not determine retirement savings need. A higher level of education is associated with greater planning and men tend to plan more than women—a disturbing finding given that women tend to live longer than men."

A history of plan participation appears to play a role in the resources used. For example, those workers who have never taken part in an employer-sponsored plan are significantly less likely than those who currently do or have done so in the past to say they have used a financial professional or automated statements from financial providers. They also are much more likely to "guesstimate," or make informal calculations. Moreover, 28% of those who have never participated in an employer-sponsored plan have only guesstimated, compared to 14% of workers who have ever taken part and 8 percent of those who currently participate.

Workers who have participated in a workplace plan use more rigorous tools to determine retirement income needs. For example, 58% of those who currently participate in a workplace retirement plan have used online tools or calculators to determine retirement income needs, as well as 46% of those who have ever participated in a workplace retirement plan. Thirty-nine percent of those currently participating in a workplace retirement plan have used a financial professional to determine retirement income needs, as well as 43% of those who have ever participated. Only 16% of those who have never participated in a workplace retirement plan have used a financial professional to calculate future income needs. "Getting these resources into workers' hands will very likely result in an increase in their use," Scott said.

Having any retirement savings does not mean that respondents actively contribute to such a plan. For example, a person might have contributed money or rolled over a prior retirement account to an IRA but is not currently making contributions. When asked, 38% of workers who have any savings but do not have access to an employer-sponsored plan said that they had not contributed in the past two years; 3% said they were not allowed to contribute.

Among those currently participating in employer- sponsored plans, only 8% did not contribute or had decreased their contributions, compared with 45% to 52% of all others regardless of current access or participation history.

Asking how workers would use a hypothetical $10,000 windfall can help reveal savings and spending priorities, Pew says. On average, those without access to a retirement plan would allocate $1,580 toward retirement, more than those with access to a plan who are not currently participating, possibly because they cannot save at work. Workers are more likely to use the hypothetical money to pay down debt or build liquid savings than to boost retirement savings, which suggests that these factors may be more pressing concerns for many workers.

“Paying down debt was the top response for all survey participants. Retirement savings should be viewed in the context of workers’ broader financial situation. Policymakers may consider combining retirement savings with help with other financial priorities,” Scott said.

WHAT RAISING SOCIAL SECURITY’S RETIREMENT AGE REALLY MEANS

Social Security faces a long-term financial crisis. The demographic bump of baby boomers retiring in recent years will continue to flow into the Social Security system for many years to come, and the corresponding outflow of Social Security benefits will not only use up all available payroll tax revenue, but also eat into Social Security trust fund reserves. Current projections suggest that by the mid-2030s, Social Security will have a shortfall that leaves roughly a quarter of scheduled benefits unfunded. Many lawmakers see raising the full retirement age for Social Security benefits as a potential solution to the program's financial woes. Proponents cite the rise in life expectancies and the resulting shift in demand for Social Security as reasons to modify the retirement age upward. Yet with many of the proposals to raise the retirement age, the net impact likely will not be to get people to claim Social Security later but rather simply to reduce what they receive when they do claim.

The history of Social Security's retirement age
Proposals to increase the retirement age for Social Security are not new. One need only look back at history to see how such ideas have played out in the past. Back in the early 1980s, a grand compromise between President Ronald Reagan and a Democratic-controlled Congress led to a gradual increase in the retirement age. Over the course of nearly 40 years, the retirement age went from 65 to 67, with a long break in the middle at 66. Currently, those who have turned 62 in the past year have started to see slightly older retirement ages, and the age will rise in two-month increments annually before topping out at 67. Now, lawmakers are looking at similar proposals for the future. Ages of between 68 and 70 have been suggested for a possible new law, with the same arguments about economic stability of the program supporting the moves. Yet amid most of the proposals, few actually stop to look at the actual impact on benefits that would occur.

Does a higher retirement age really affect behavior?
The way that most people discuss potential increases in the retirement age suggests that people would end up working longer. There is an idea that most people used to work until hitting 65. When the Social Security full retirement age and the age for claiming Medicare were aligned at that same

65-year-old point, there were multiple reasons why people would target 65 as a prospective retirement date. Yet still when it comes to claiming actual benefits, few people wait that long, and the rise in retirement age to 66 and subsequently toward 67 has shown no signs of reversing that trend. More people claim at 62, when early Social Security benefits first become available to workers, than at any other age. That fact has not changed markedly, even with changes in the full retirement age under the program.

Higher full retirement age + no change in claiming behavior = benefit cut
When lawmakers advocate for higher retirement ages without making similar changes to the age for collecting early benefits, then net impact is simply to cut monthly benefits to retirees. The exact amount depends on the age at which you would claim, but in general, benefits go down between 5% and 10% for every year that the retirement age goes up. What happens when the full retirement age went from 65 to 66 and what will happen as it moves to 67? Similar cuts would occur under current law if retirement ages were increased from 67 to higher levels. Proponents argue that giving early retirees the chance to get at least some benefits is better than simply eliminating the ability to claim early at all. Yet with many people relying on Social Security for the bulk of their retirement income, reducing that amount further from current levels is a recipe for financial disaster for millions of Americans.

Consider the consequences
There is no easy solution to Social Security's financial woes, and other proposals to shore up the system would also have impacts on participants and the American public as a whole. As lawmakers come up with new ideas, you will want to look at them closely to see what the true impact is likely to be. Only if you are comfortable with all the consequences does it make sense to support one proposal over another. Well written piece by Dan Caplinger.

Private Sector

IRS Announces 2018 Pension Plan Limitations Not Affected by Tax Cuts and Jobs Act of 2017

The Internal Revenue Service today announced that the Tax Cuts and Jobs Act of 2017 does not affect the tax year 2018 dollar limitations for retirement plans announced in IR 2017-177 and detailed in Notice 2017-64.

The tax law provides dollar limitations on benefits and contributions under qualified retirement plans, and it requires the Treasury Department to annually adjust these limits for cost of living increases. Those adjustments are to be made using procedures that are similar to those used to adjust benefit amounts under the Social Security Act.

As the recently enacted tax legislation made no changes to the section of the tax law limiting benefits and contributions for retirement plans, the qualified retirement plan limitations for tax year 2018 previously announced in the news release and detailed in guidance remain unchanged.
The tax law also specifies that contribution limits for IRAs, as well as the income thresholds related to IRAs and the saver's credit, are to be adjusted for changes in the cost of living using procedures that are used to make cost-of-living adjustments that apply to many of the basic income tax parameters.

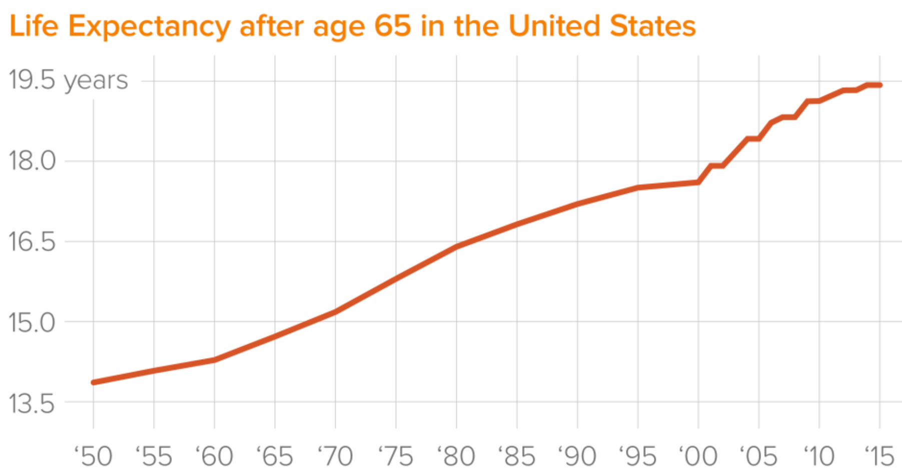
Although the new law made changes to how these cost of living adjustments are made, after taking the applicable rounding rules into account, the amounts for 2018 in the news release and the guidance remain unchanged.

Longevity and technology are transforming the way people retire

Living to be 80 or 90 years old was once considered an anomaly.

In fact, when social security was first introduced in the US in the 1930s, the average life expectancy at birth was just 58 for men and 62 for women. But today—though still rare—it's not unheard of to celebrate grandma's 100th birthday. Studies suggest that if life expectancy rates continue to increase at the speed they've experienced since the 1800s, centenarians may be the norm by the year 2100.

Those who plan to retire in the 21st century will experience post-career life in a wildly different way than previous generations. While people used to look forward to 10 or so years of golfing, fishing, and globetrotting, the retirees of the not-too-distant future may need to plan on decades of retired life.



Empowered by the potential of longer lives, today's retirees are getting creative about how they spend their time, shifting focus to more productive endeavors. Technological advancements and innovations in connectivity, mobility and the sharing economy have made retirees' lifestyles much less passive than the stereotypes of the past.

Continued Enrichment

In the "typical" retirement scenario of the future, second-act opportunities abound. Already, people over the age of 55 comprise America's fastest growing demographic of entrepreneurs, and more and more older Americans are picking up part-time work like editing, consulting, or customer service. Technology has also given this cohort access to skill-building tools, like massive open online courses (MOOCs) at top-tier universities, and online learning resources like Coursera. Using these platforms, older adults can hone skills ranging from 101-level business acumen to bilingualism to playing the accordion.

New-age Income

Sharing-economy platforms have also created numerous ways of generating passive income. Renting out a vacation home on a platform like Airbnb makes it simple to put property to work. Some retirees even sign up for gig-economy stints through online freelance marketplaces, or the like to offset the growing lack of company-offered pensions.

Staying Connected

Social media, too, has opened doors for communication and community-building among retirees. It's never been easier to connect with friends, family, and like-minded strangers on the opposite side of town—or even across oceans. And before you surmise that the 65+ age group tends to be technologically inept, think again: Social media use among this demographic tripled between 2010 and 2016.

There are even dedicated social networks for people over a certain age, catering to a fifties-plus crowd, and dating sites solely intended for seniors. All this social stimulation bodes well for longevity—science suggests that maintaining social connections in retirement can boost health, increase happiness, and reduce the risk of dementia.

Tax and Budget Bills Include Tax Qualified Retirement Plan Provisions

The tax bill enacted late last year (Public Law No. 115-97) and the budget bill enacted earlier this month (the Bipartisan Budget Act of 2018) included a handful of changes to the rules applicable to tax-qualified retirement plan distributions. Generally, the changes are intended to provide more flexibility for retirement plan distributions. Most are immediately effective but some will not become effective until next year.

Plan Loan Offsets

The tax bill extends the rollover deadline for "plan loan offsets." Plan loan offsets are otherwise taxable distributions that result from certain loan payment defaults (usually defaults resulting from nonpayment of a loan that accelerates at termination of employment). These distributions are eligible for tax-free rollover to another retirement plan. Under prior law, the deadline for rolling over a plan loan offset distribution was the same as any other eligible rollover distribution 60 days after the date of the distribution. The tax bill extends the deadline for rolling over a plan loan offset distribution to the due date of the participant's federal income tax return (including extensions) for the year in which the plan loan offset distribution is treated as occurring. The tax bill effectively gives the participant additional time to repay a loan and avoid a taxable distribution.

This provision of the tax bill is effective for plan loan offsets treated as distributed in tax years beginning after December 31, 2017. It applies only to plan loan offsets that occur solely by reason of plan termination or the failure of a participant to meet the repayment terms of the loan because of the participant's severance from employment. It does not apply to "deemed distributions" that occur with respect to loan defaults prior to the date on which the participant is otherwise eligible to receive a distribution. Nor does it apply to deemed distributions attributable to the failure of a loan to be properly structured as a tax-free loan in the first place.

Hurricane and Wildfire Disaster Relief

Under the tax bill, a current or former employee whose principal residence was in the Hurricanes Harvey, Irma, or Maria disaster areas and who sustained economic loss (including property damage, home displacement, or job loss) can receive distributions of up to $100,000 from their retirement plans (including tax-qualified retirement plans, 403(b) plans, and individual retirement accounts) that take advantage of a number of special tax rules:

- The distributions can be included in income ratably over three years.
- If otherwise eligible for rollover, the distributions can be repaid tax-free to a retirement plan at any time up to three years from the date of distribution.
- The distributions are not subject to the 10 percent excise tax that may otherwise be applicable to distributions made prior to age 59 1/2 and are not subject to mandatory 20 percent withholding.
- The distributions can be permitted by the plan even if they are not otherwise permitted by the Internal Revenue Code. For example, employees can take these distributions even if they are still employed, under age 59 1/2 and would not otherwise satisfy the requirements for a hardship distribution.

These provisions apply to distributions made before January 1, 2019, and after August 22, 2017, for Hurricane Harvey, after September 3, 2017, for Hurricane Irma, and after September 15, 2017, for Hurricane Maria. To be eligible, the current or former employee's principal residence must have been located in the applicable disaster area on August 23, 2017 (Harvey), September 4, 2017 (Irma), or September 16, 2017 (Maria).

The budget bill contains similar relief for distributions to a current or former employee whose principal residence at any time from October 8, 2017, to December 31, 2017, was in the California wildfire disaster area. The California wildfire disaster area distribution provisions apply to distributions made on or after October 28, 2017, and before January 1, 2019. In addition, the budget bill includes two provisions designed to give participants affected by the California wildfires more access to plan loans:

- It temporarily increases the maximum amount that may be withdrawn as a loan to 100 percent of the employee's vested account balance up to $100,000. This provision applies to loans between February 9, 2018, and December 31, 2018.

- It postpones the due date for any loan repayment otherwise due between October 8, 2017 and December 31, 2018, for one year if the loan was outstanding on or after October 8, 2017. The postponed payment must be adjusted for additional interest and the extended loan repayment is disregarded for purposes of the five-year limit on general purpose loans.

Hardship Withdrawal Changes

The budget bill includes several provisions that facilitate hardship withdrawals from 401(k) and 403(b) plans, all of which become effective for plan years beginning after December 31, 2018:

- Elimination of Six-Month Contribution Suspension. Under current Internal Revenue Service regulations, a 401(k) or 403(b) plan participant is permitted to take a hardship distribution only if the distribution is necessary to satisfy an immediate and heavy financial need. The regulations include a "safe harbor" under which a distribution will automatically be treated as necessary to satisfy an immediate and heavy financial need of the participant if, among other things, the participant's right to contribute to the plan is suspended for at least six months. The budget bill directs the Internal Revenue Service to modify the regulation to delete the six-month contribution prohibition from the safe harbor.
- Expansion of Hardship Withdrawal Sources. The budget bill expands the sources of contributions from which 401(k) hardship withdrawals may be taken to include earnings on elective deferral contributions and so-called "qualified nonelective contributions" and "qualified matching contributions," which are contributions that plan sponsors can make to remedy a plan's failure to pass nondiscrimination testing. The bill also makes clear that hardship withdrawals may be taken from profit sharing plans.
- Elimination of Requirement to Take Loans. The budget bill eliminates the requirement that a participant take all available loans under the plan as a condition to receiving a hardship distribution.

Recontribution of Returned Internal Revenue Service Levy Amounts

Under the budget bill, if an amount was distributed from a retirement plan (including a tax-qualified retirement plan, a 403(b) plan or an individual retirement account) pursuant to an Internal Revenue Service levy and the Internal Revenue Service returns the levy to the participant, the participant may recontribute the amount returned by the Internal Revenue Service (plus any interest returned to the participant) to the plan. The contribution must be made no later than the due date (not including extensions) for the participant's federal income tax return for the year the levied amount was returned to the participant. To the extent recontributed, any taxes paid on the distribution are refundable (unless the distribution was made from a non-Roth account and recontributed to a Roth account, which would effectively be treated as taxable Roth conversion). This provision is effective for levy amounts returned by the Internal Revenue Service in tax years beginning after December 31, 2017.

What Do Plan Sponsors Need to Do?

None of the tax-qualified retirement plan provisions in the tax and budget bills require retirement plan sponsors to make any changes to their retirement plan designs. That said, many plan sponsors will want to consider accepting repayments of qualified plan loan offset distributions, disaster-related distributions and returned Internal Revenue Service levy distributions, and allowing plan participants to take advantage of the looser hardship withdrawal rules and the California wildfire disaster loan provisions. Plan sponsors may implement any of these changes operationally immediately or, in the case of the changes to the hardship withdrawal rules, beginning in 2019. The deadlines for adopting amendments reflecting any operational changes may vary and plan sponsors should consult with their advisors regarding those deadlines.

Two provisions of the tax and budget bills require plan sponsors to adjust plan administration:

- The one-year extension for loan repayments by individuals affected by the California wildfire disaster is mandatory. Plans that permit loans will need to permit adjustments to loan repayment schedules for these individuals.

- Because the tax and budget bills exempt disaster-related distributions from the 10 percent early distribution excise tax and 20 percent mandatory withholding, it appears that plan sponsors will need to adjust their reporting of disaster-related distributions and withholding for those distributions. For example, the Internal Revenue Service has recently suggested that Form 1099-R for a distribution to a participant who qualifies for hurricane relief under the tax bill should be marked with Code 2 in Box 7 to signify that the distribution is exempt from the 10 percent early distribution excise tax. Presumably, the Internal Revenue Service would expect similar reporting to a participant who is eligible for California wildfire relief under the budget bill. It is not clear how a plan would determine a participant's eligibility for disaster-related distribution tax-relief. Presumably, it may rely on the representation of the participant assuming the plan is not otherwise aware of facts that would disqualify the participant from relief.

DC participants with 401(k)s and HSAs have higher savings rates for 401(k) and overall

Defined contribution plan participants who are eligible to participate in 401(k) plans and health savings accounts save more than people who just use 401(k) plans, according to research by Alight Solutions.

"These people are proactively saving," said Robert Austin, director of research, in an interview Wednesday. "These people understand these are good savings mechanisms."

An Alight research report issued Tuesday showed that participants using 401(k) plans and HSAs had higher aggregate savings rates than those using just 401(k). More notably, it showed that the 401(k) savers who also contributed to HSAs had higher 401(k) savings rates than those just using 401(k) plans.

For example, Alight found that the savings rate for participants using a 401(k) plan in conjunction with an HSA had an average 401(k) savings rate of 8.9% plus another 2.9% for the HSA. By contrast, the savings rate for 401(k)-only participants was 6.8%.

"The data shows that the apprehension (by sponsors) that HSAs will cannibalize 401(k) savings doesn't hold," Mr. Austin said. "Don't let fear be a deterrent to putting in an HSA. Don't worry about one getting in the way of the other."

The Alight data, based on a survey of 34 clients with 1.1 million participants, showed that the higher 401(k) savings rates among participants also saving via an HSA vs. the 401(k)-only group held true at all salary levels. Alight looked at five salary categories ranging from a low of $20,000-$40,000 to $100,000-$250,000.

The Alight report also said "pay is the key driver" for participants using 401(k) plans and HSAs. In the $100,000-$250,000 group, for example, 80% used both. In the $20,000-$40,000 group, 48% used both.

"Lower paid workers are less likely to enroll in an HSA-eligible health-care plan," the report said, noting that 44% of workers earning below $60,000 were enrolled in such a plan. Fifty-three percent of workers earning at least $60,000 were enrolled in this type of plan.

Should pensions care about corporate bond supply?

For years, pension plan sponsors and fixed income managers have been concerned about the availability of investment grade corporate bonds. Corporations are presumed to be less likely to issue debt in the future given the new corporate tax law. Pension plans, who like to use corporate bonds to hedge liabilities, are becoming better funded with positive market returns and hefty contributions which reduce PBGC premiums and maximize deductions before tax rules change. Better funding leads investors to shift asset allocations toward fixed income, which in turn presumably will significantly increase demand for corporate bonds, especially as plans close or freeze. What's a pension investor to do?

Liabilities and corporate bond supply

Pension plan liabilities are calculated using yield curves built from baskets of high quality corporate bonds. Naturally, therefore, the liability's value moves like corporate bonds with changes in treasury rates and credit spreads. Liabilities increase if either treasury rates fall or credit spreads narrow; conversely, liabilities decrease if either treasury rates rise or credit spreads widen. So, it seems sensible that corporate bonds would nicely hedge liabilities, and, in fact, they mostly do when evaluating bonds in isolation against the liabilities.

If supply of corporate bonds diminishes for any reason, like less incentive to issue debt because of new tax laws, and if demand for the corporate bonds that exist now increases because pension plans become better funded, then you can see why a pension plan sponsor or a long credit or long corporate investment manager would begin to worry. Buying corporate bonds later, when yields are compressed because buyers are compelled to pay more and more in a crowded market on a limited supply, could be expensive and time consuming. It even seems like it might be prudent to start building the bond portfolio sooner rather than later if you think buying corporate bonds might get harder in the future.

Offsetting liability spreads is messy

Liability returns are determined by treasury rate and spread changes. Given that treasury bond issuance is one and a half times that of investment grade corporate bonds1 and that average daily trading volume of treasuries is more than 15 times corporate debt2, perhaps they can be used to offset the supply problem. Treasury bonds have no credit spread exposure but can be used to hedge the treasury rate movement of liabilities extremely well. But, what about spreads?

Spreads create a several problems. One is that liability spreads are based on a basket of bonds that have different cash flows than the liabilities and from each other. Some bonds will have more influence on one rate along the curve than another. In any event, it is completely impossible to invest in a set of bonds that will match the cash flows and yields on which liabilities are based. Another is that those baskets of bonds change from period to period based on ratings and which subset of bonds within that rating are chosen. In the case of downgrades and defaults, the liabilities don't lose value, because those bonds simply fall out of the basket of bonds used for the yield calculations. But if you have those bonds in your asset portfolio, your assets surely do lose value. This creates a problem where it's impossible to maintain a set of bonds that keeps up with the liability return at the same risk level.

So now we're left with a problem where treasuries do an excellent job of offsetting the treasury rate exposure, but completely miss on the credit spread exposure. Complicating matters further, we need to be concerned that credit spread exposure can't be offset well, even with corporate bonds, because no matter what you do there will be a huge amount of basis risk when it comes to credit spreads. Either way you might find it hard to keep up with liability returns over a long horizon.

A solution

Luckily, we've advanced to the point where we can evaluate the liabilities against the total asset portfolio, including return seeking assets, rather than just a single sleeve. After all, our overall goal is to achieve the right balance of risk and reward for the total portfolio, not simply within the bond portfolio.

Along those lines, let's consider equities. Looking back at historical spread returns on long corporate bonds, an interesting pattern emerges. If the credit spreads narrow dramatically, equity returns are typically very large. Conversely, when spreads blow out you will often see large negative returns on equity.

In a total plan context, this is important. Corporate bonds seem a good fit because the spread return of the bonds and liability are related (interest rate exposure can be taken care of with just treasuries). On a total plan basis, other assets have returns related to the spread return, too.

If liabilities increase because spreads narrow, we want our assets to rise enough to offset that. Historically, it hasn't taken very much equity to offset the liability growth from narrowing spreads. No additional credit spread exposure from corporate bonds was needed to keep up. Going the other direction, as spreads have widened and liabilities decreased, equities have often fallen even further. That is harmful to the plan's funded status, but that problem is only exacerbated by also having credit exposure in bonds.

Summary

The point here is that from a total plan perspective, perhaps we need not worry so much about a diminishing supply of credit after all. Rather, we can get spread exposure in ways we hadn't considered, including the equity or other return seeking assets that may already be in the portfolio. Regarding the liabilities, why not use treasuries to hedge what you can and then pick the best portfolio of return-seeking assets to cover what you can't, while balancing both in terms of total plan outcomes?

1 Treasury Notes and Bonds issuance in 2017, 2016 and 2015 was $1.914 trillion, $1.854 trillion, and $1.803 trillion, respectively, while Investment Grade Corporate Bond issuance was $1.318 trillion, $1.279 trillion, and 1.216 trillion. Source: SIFMA, data as of the end of December 2017.

2 Average Daily Volume of Treasuries was $504.8 billion, of Corporate Debt was $30.7 billion. Source: SIFMA; data as of end of December 2017.