BCG Retirement News Roundup

March 2018 Volume 7, Issue 3

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

www.boomershineconsulting.com 410-418-5525

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

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

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

Inside This Issue

Public Sector/Government Plans

Private Sector

Public Sector/Government Plans

W. Va. Bill Would Criminalize Failure to Make Public Pension System Contributions

Under the proposed legislation, any employer or public official who willfully fails to make contributions to public pension plans can face a sentence as low as a $100 fine or as high as 10 years in prison.

A bill introduced by the West Virginia legislature would make it a criminal offense for any participating public employer of any retirement system administered by the Consolidated Public Retirement Board to fail to make required contributions.

It would also authorize the State Auditor, county commission and sheriff to withhold any money due the participating public employer by the state or county and to remit the monies to the applicable retirement system. If any participating public employer fails to make any payment due any retirement system administered by the Consolidated Public Retirement Board for a period of 60 days after the payment is due, the participating public employer shall become delinquent, and such delinquency shall be certified by the Consolidated Public Retirement Board to the State Auditor, the county commission of the county in which the participating public employer is located, and/or the sheriff of the county in which the participating public employer is located.

In addition to any other penalty or punishment otherwise prescribed by law, the bill provides that any employer who is party to an agreement to pay or provide benefits or wage supplements and who without reasonable justification willfully fails or refuses to pay the amount or amounts necessary to provide such benefits or furnish such supplements within thirty days after such payments are required to be made, shall be guilty of a misdemeanor, and, upon conviction thereof, shall be fined not less than $100 nor more than $500. When such employer is a corporation, the president, secretary, treasurer or officer exercising responsibility for such nonpayment shall be guilty of the offense.

In addition, any public official who is responsible for ensuring that a public entity comply with the general laws and provisions of a public pension plan administered by the Consolidated Public Retirement Board who knowingly and willfully fails to make employee or employer contributions to the retirement plan shall be guilty of the larceny of the contributions owed, and, if the amount is $1,000 or more, such public official shall be guilty of a felony and, upon conviction thereof, shall be imprisoned in the penitentiary not less than one nor more than 10 years, or, in the discretion of the court, be confined in jail not more than one year and shall be fined not more than $2,500. If the amount is less than $1,000, such public official shall be guilty of a misdemeanor and, upon conviction thereof, shall be confined in jail for a term not to exceed one year or fined not to exceed $2,500, or both, in the discretion of the court.

Oregon Passes Law to Boost Public Pensions

Two funds will be created to help reduce the state's $25 billion in unfunded liabilities.

Oregon Gov. Kate Brown has signed into law a bill that establishes two funds to help the state's schools and other public employers cover growing public pension costs.

One of the funds would receive the majority of the money, as much as several hundred million dollars by some estimates, which would be deposited with Oregon's Public Employees Retirement System (OPERS) in a pooled side account for school districts. That account would be invested along with existing pension assets, and gradually drawn down to reduce pension contributions required by the school districts.

The second, smaller fund is intended to get Oregon public employers to use their own resources to make extra one-time contributions to the pension fund, which the state would then match at $0.25 on the dollar as an incentive. That money would go into individual employers' side accounts at OPERS, and would be invested with existing pension sets, and gradually drawn down to reduce the employers' contributions. Approximately 900 employers participate in OPERS.

The funds will be capitalized with $140 million in new revenues, according to The Oregonian. Approximately $115 million of that money would go to the school side account, while the remaining $25 million would capitalize the employer incentive fund.

The new law originated from a task force Brown appointed last year to investigate ways the state could reduce OPERS' unfunded actuarial liability of $25 billion by $5 billion over five years. Some of the proposed actions by the task force can be seen in the new law, which would establish an employer incentive fund for contributing to OPERS side accounts.

The bill will use various sources for capitalizing the school pool, and the employer incentive fund, such as proceeds from marijuana tax, lottery revenue, debt collection, capital gains taxes, estate taxes, lawsuit settlements not dedicated to a specific purpose, and interest from the unclaimed property account within the Common School Fund.

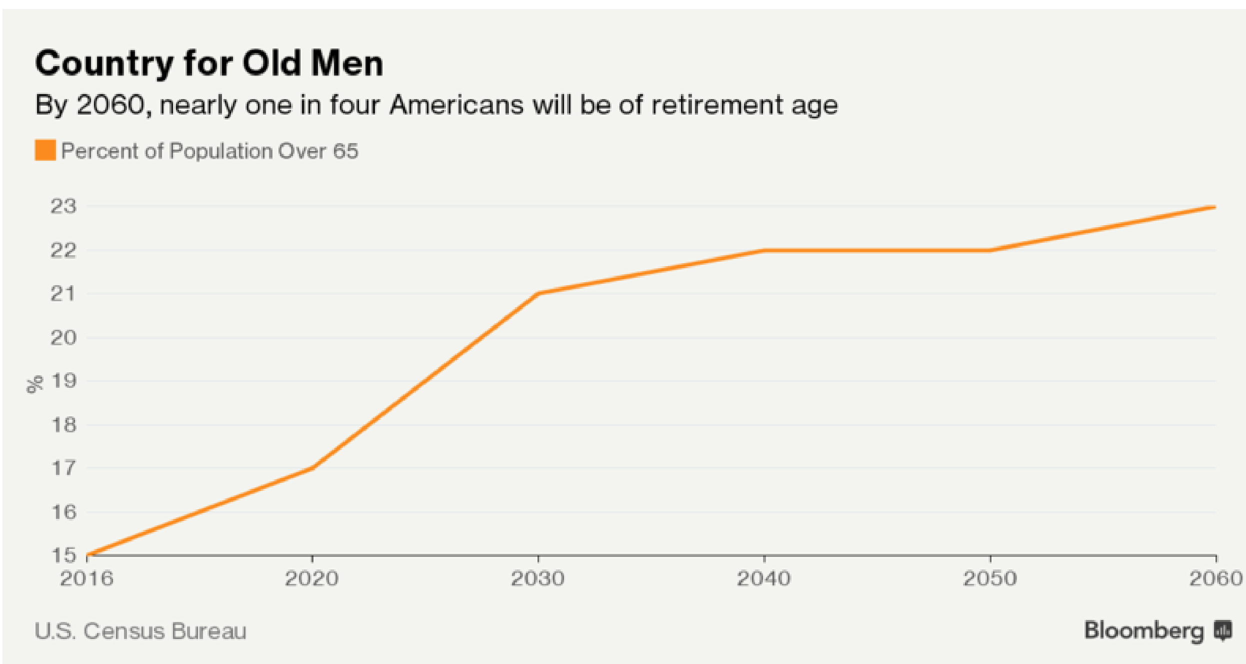
The bill passed through the Senate unanimously, and by a more than 2-1 margin in the state's House of Representatives.

According to the Oregon School Boards Association (OSBA), the costs to OPERS for public employers, including school districts, are expected to keep climbing for at least the next few budget cycles. It also said that average OPERS rates are nearly 15% of payroll, and the average is expected to climb to more than 25% of payroll by the 2023.

A Worrying Shift for Pensions: Retirees Will Soon Outnumber Kids

For those worried about the ability of U.S. state and local governments to cover promised pension checks, the Census Bureau announced a milestone that should add to their fears: by 2030, for the first time, senior citizens will outnumber children.

In 12 years, about one in five Americans will be of retirement age, and by 2035, those 65 and older will outnumber those under 18 by about 2 million, according to the latest estimates released by the agency. The consequences are wide-ranging, from the solvency of Social Security to increased health-care costs for an aging population.



The swelling ranks of retirees from public service, such as police officers and teachers, will also present a strain on state and local government retirement systems that have about $1.6 trillion less than what they need to cover the benefits workers are counting on.

That shortfall is the result of investment losses, overly aggressive investment forecasts, inadequate contributions and perks granted in boom times. Governments will need to pay more into the funds to make up that gap, putting a squeeze on their budgets that could imperil their bond ratings and diminish services for residents.

After the recession, American governments laid off workers and cut back on hiring, leaving fewer paying in as the number of retirees grows. The ratio of active workers to those receiving benefits has dropped to 1.42 from 2.43 in 2002, according to a survey of the largest public pensions conducted by the National Association of State Retirement Administrators.

Fully funded plans would have enough assets to cover the projected payouts. But for those already facing gaps, the burden to pay for the benefits for current and future retirees will be even higher.

Kentucky budget director sues state pension coalition to keep actuarial analysis under wraps

Kentucky Budget Director John Chilton is suing the state's Public Pension Coalition over the group's request to review an actuarial analysis of the governor's pension reform plan that was announced in October.

The lawsuit was filed in Franklin County Circuit Court last week against Ellen Suetholz, coordinator of the coalition that represents active and retired public employees.

In November, Ms. Suetholz requested the state budget director release a copy of the actuarial analysis of Gov. Matt Bevin's pension reform plan, which called for automatically moving some future workers and eventually some active workers into defined contribution plans, among other changes. Mr. Chilton denied her request, arguing that the documents were preliminary and did not need to be disclosed.

Shortly after, Ms. Suetholz appealed to Kentucky Attorney General Andy Beshear, who decided on Feb. 5 that Mr. Chilton had violated the Kentucky Open Records Act and gave the budget director 30 days to release the analysis.

In the lawsuit, which was filed 31 days after Mr. Beshear's decision, Mr. Chilton argued that his earlier statement on the preliminary nature of the analysis "is even more true now" than when it was made. He noted that the governor's pension reform proposal was not introduced to the Kentucky General Assembly and that legislators are currently working on a pension bill that differs significantly from Mr. Bevin's proposal.

"This is really unfortunate that the Bevin administration has resorted to suing their own constituents to get their way," said Ms. Suetholz in a news release from the Kentucky Public Pension Coalition earlier this month. "It's rather unusual for a governor to take such a drastic step to prevent disclosure of a taxpayer funded document. It seems that the governor and his administration will go to any lengths to shield any negative news coverage. This has been a complete lack of transparency on their part." Mr. Chilton and a spokeswoman for Mr. Bevin could not immediately be reached for comment.

Del. Lisanti: Full State Tax Exemption for Military Retiree Pensions Clears the Maryland House of Delegates

From Del. Mary Ann Lisanti:
After a decade of failed attempts by advocates and legislators, House Bill 327 Income Tax – Subtraction Modification – Military Retirement Income, Sponsored by Delegates Mary Ann Lisanti, (D) Harford County and Pat Young, (D) Baltimore County has achieved an important milestone by passing the Maryland House of Delegates Monday 134-0 and is now on its way to the Maryland Senate. Hearings will be held before the Senate Budget and Tax Committee on March 28th, where action must be taken before the 90 day legislative session ends at midnight on April 9, 2018.

The bill in its amended form will phase-in the full tax exemption of all military retirement income being fully exempt from Maryland state income taxes beginning after December 31, 2021. The phase-in will occur over three taxable years. For those veterans under 65 years of age the bill calls for a year one $7,500.00 deduction, year two $15,00.00, year three $21,000.00 and full exemption year four. For those over 65 years of age the phase-in will be front loaded with the year one deduction set at $12,500.00, year two $20,00.00, year three $25,000.00 and full exemption will also be reached by year four.

This bill represents a compromise that was born from a package of bills submitted by Delegates Young and Lisanti. Both have been working over the 2017 interim on various funding strategies that addresses the significant fiscal impact of exempting military retiree pensions. “Gaining the support from the necessary committees and House members has been no easy task, but at the end of the day we all recognize what the passage of HB 327 will mean for our Veterans in the State of Maryland." Said Delegate Young. "As we commemorate the 50th anniversary of the Vietnam War it would be a fitting tribute to join other surrounding states in exempting military retirement income form state taxes." "The legislature has been working on reducing the tax burden on our Veterans for some time now…It is about time we move aggressively to keep our retired members of the military here in Maryland." said Delegate Lisanti

Maryland is home to over 55,000 veterans that receive a pension earned during their military service. Under current law they are able to write off the first $10,000 of their retirement income. Three of the four surrounding states exempt military pension income from state taxes which has had an impact on whether service members who retire from the military decide to remain in Maryland. "It's easy to move across the border and make the commute to work in order to save more of their retirement income." "Employers know that veterans are good workers. They are reliable, committed to the community with a strong work ethic, and therefore keeping them in Maryland after retirement has added benefits to enhancing Maryland workforce." said Delegate Lisanti.

Private Sector

Bill Seeks to Help Individuals Find Unclaimed Retirement Benefits & Provide Relief to Employers with Benefits Due Missing Participants

Senators Elizabeth Warren (D-MA) and Steve Daines (R-MT) have introduced the Retirement Savings Lost and Found Act of 2018 (the Act). The Act would create the Office of Retirement Savings Lost and Found, which would rely on new tools and build on existing reporting and disclosure rules to achieve two overall objectives: 1) assist participants and beneficiaries in finding and obtaining unclaimed retirement benefits in plans subject to ERISA's vesting rules, and 2) provide plan administrators with a new option for balances of missing or lost participants. The bill would generally become effective the second year after it is enacted.

Retirement Savings Lost and Found Database

The Act would require the Commissioner of Social Security and the Secretary of the Treasury to create an online database called the Retirement Savings Lost and Found (RSLF). The objective of the database would be to allow individuals—with assistance from the RSLF Director, if needed—to locate the plan administrator of plans in which they have benefits.

The database would be populated with information gathered from IRS Form 8955-SSA, Annual Registration Statement Identifying Separated Participants with Deferred Vested Benefits. This form would be modified to include information such as
the name and taxpayer identification number of participants or former participants whose benefits were either paid out, automatically rolled over to an IRA , or distributed in the form of a deferred annuity contract; the name and address of the IRA trustee that received an automatic rollover of a cash-out amount; and the account or contract number into which the assets were placed.

When participants separate from service, plan administrators would be required to provide them with information about the availability of the RSLF.

Plan administrators who automatically roll over a cash-out amount to an IRA would also be required to notify the receiving IRA trustee that the rollover is a mandatory distribution.

The statute suggests that changes could be made to IRS Forms Form 1099-R, Distributions From Pensions, Annuities, Retirement or Profit-Sharing Plans, IRAs, Insurance Contracts, etc., and IRS Form 5498, IRA Contribution Information to satisfy the Act's reporting requirements for the year such amounts are rolled over.

The reports would be required to state that such rollovers are mandatory and would be required to be filed with the RSLF Director.

Additional Relief Regarding Small Balances and Benefits of Missing Participants

In addition to creating the online RSLF database for those seeking unclaimed retirement benefits, the Act provides new options for plans to dispose of small balances and provides a compliance cushion when certain requirements can't be met because a participant or beneficiary is lost or missing.

Small Balance Disposition

In addition to creating an online information bank to assist in claiming benefits, the Act would also make the following changes for small, unclaimed balances.

The involuntary cash-out limit for former participants would increase from $5,000 to $6,000.
After notifying former participants, plan administrators would be required to roll over balances of $1,000 or less to either an IRA established by the Secretary of Treasury or to the RSLF if the participant fails to claim the assets within six months. For tax purposes, a rollover to the RSLF would be treated as a rollover to an IRA and subsequent distributions would be treated as from an IRA.
For purposes of fiduciary relief under ERISA Sec. 404(c), the Act would expand the circumstances under which individuals are deemed to exercise control of accounts that are automatically rolled over to include rollovers made to target date or life cycle funds held under the IRA, the RSLF Director, an IRA established by the Secretary of the Treasury, or any other option provided by Secretary of Labor.

Relief Regarding Missing Participants

The Act would generally provide relief for plan fiduciaries by specifying that a plan administrator or other plan fiduciary would generally not fail to comply with any requirements under the Internal Revenue Code (IRC) or ERISA—including the requirement to pay required minimum distributions or to provide documents, information, etc., to missing individuals; when an individual is no longer considered missing, there would be a 180-day grace period for satisfying requirements under the IRC or ERISA, after which any temporarily suspended requirements must be met; and the PBGC's missing participant program, which now includes defined contribution plans in addition to defined benefit plans, will remain an option—and an alternative to the RSLF—for retirement plans that cash-out small balances.

Definition of Missing Participant

For purposes of the Act, the term "lost or missing participant" generally means a participant, former participant, or beneficiary of a participant, who cannot be located despite a plan administrator or other responsible party (e. g., a plan service provider or an IRA trustee) having satisfied its Form 8955-SSA reporting obligation; made at least one attempt to contact the participant at the most recent address on file with the plan; and taken one or more additional measures to locate the participant, including checking with the administrator of a related plan, attempting to contact the participant's beneficiary, conducting a search using a free electronic search tool, and using a commercial locator service.

Conclusion

The issue of unclaimed benefits—and the difficulty plans face meeting the requirements to dispose of them—are becoming more and more visible. Equally visible are the shortcomings of many workers in their preparedness for a financially secure retirement. Together, these factors may motivate Congress to act to at least ensure that existing retirement benefits find their rightful owners.

Given the bipartisan sponsorship and support for this bill's concepts, it is possible that some or all of its provisions—on their own, or attached to other legislation—could find their way to enactment.

The Mobile Workforce's Missing Participant Problem A Study by Boston Research Technologies and Retirement Clearinghouse

Methodology
About the Study

• First of its kind research that explores the scope of the mobile workforce missing participant problem with retirement plans
• BRT conducted the study in collaboration with Retirement Clearinghouse
• 1,000 consumers who had participated in at least one retirement plan in the past were surveyed
• Survey conducted from February 8 – February 9

Executive Summary

Key Findings

➢ 11% of all terminated account records had a stale address ("missing")

➢ 1 out of every 5 job changer relocations results in a missing participant

➢ The probability of locating a missing participant with an active participant address record is 67%

➢ 9% of participants would not verify their address if asked by a former employer

➢ One third of participants learned of a retirement account with a previous employer they did not realize they had

➢ 60% of participants preferred an automated process to update address or consolidate accounts

Stranded Account Profile

Mobile Workforce Leaving 401(k) Accounts Behind

➢ 11% of stranded accounts had a stale address

➢ 1.42 stranded accounts per participant

➢ 31% of stranded accounts had balance less than $10,000

- 73% of accounts < $100,000

➢ 33% of participants in survey learned of an account they did not realize they had

50% of Millennials

The strongest predictor of the account not being lost was the respondent's knowledge of how to contact the company holding the account - accounts held by respondents who reported being able to do this were almost 7 times less likely to be lost

Missing Participant Profile

Lower Income

➢ 36% of missing participant account holders had household income below $50,000, 31% from $50,000$100,000, 33% over $100,000.

➢ Low income households twice as likely to have stale address: 18.7% of terminated participant accounts associated with participants with household income below $50,000 had a stale address, compared with 9.1% of accounts of participants with household income above $50,000

Missing Participant Profile

Younger

➢ 66% of missing participant account holders are Millennials (15.6% Millennial stranded accounts had stale address), 20% are Gen Xers (8.5% of Gen X stranded accounts had stale address), and 14% are Baby Boomers (5.9% of Baby Boomer stranded accounts had stale address)

Employed
➢ 78% of missing participant account holders are employed, 17% unemployed, 5% retired

Participant Behavior
Receive Information Through Channels That Can Become Stale Upon Move

How do you receive information about this (previous employer) account?
➢ 51% from U.S. Postal Service
➢ 15% from a work email
➢ 26% from a personal email
➢ 7% do not receive information

Participant Attitudes
Prefer Automation
➢ 60% of participants in survey would prefer an automated process to update address or consolidate their stranded accounts in their active plan
➢ 23% would utilize a lost & found database
➢ 9% would not verify their address if asked by a former employer

The Solution?
Active Participant Data
➢ 67%: Probability of locating a missing participant with an active participant record
➢ 92%: Probability the active participant record has a current address

Plan Sponsor Implications
What This Means for Plan Sponsors
➢ Demographic trends suggest the missing participant problem will grow worse before it gets better
➢ A well structured missing participant search program should be dynamic • Periodic: As records grow stale quickly, implement a periodic program to update mailing addresses • Event Driven: When large planned distributions are to occur, a more rigorous search is prudent
➢ As a best practice, encourage retirement account consolidation to eliminate redundant accounts that can go stale quickly

Target, Microsoft Lead Move Away From 401(k) Stock Investments

Verizon, Target, Comcast, and Microsoft are among the growing number of public companies rethinking the wisdom behind offering their own stock as an investment option in their workers' 401(k) plans.

In the last five years, some of the country's largest employers have taken steps to reduce or eliminate the company stock held in their retirement plans, according to securities filings reviewed by Bloomberg Law. Tactics range from total liquidation of a plan's company stock holdings—as Comcast, Xerox, and Discover Financial have done—to narrower measures aimed at reducing the amount of stock held by the plan.

Costco, UBS, and others have limited the amount of company stock workers can hold by imposing caps ranging between 10 and 50 percent of a worker's 401(k) balance. Chevron, Verizon, and Tiffany & Co. have ended their practice of using company stock to make matching 401(k) contributions. Target and Microsoft are among the companies barring employees from acquiring new shares of stock in their retirement accounts.

These companies aren't the only ones rethinking the stock in their 401(k) plans. The number of employers offering this type of 401(k) investment fell from 39 percent in 2005 to 28 percent in 2016, according to a recent study from Fidelity. What's more, the percentage of employees with company stock in their retirement accounts dropped from 41 percent to 23 percent over the same time period, Fidelity found.

Attorneys interviewed by Bloomberg Law offered different theories to explain this move away from company stock in 401(k) plans. Most described the move as a good thing for workers, at least to the extent it allowed them to maintain a more diversified retirement portfolio.

Change in Legal Landscape

The move away from company stock may be largely attributable to a single court decision. In Fifth Third Bancorp v. Dudenhoeffer in 2014, the U.S. Supreme Court eliminated the special presumption many courts had used to protect 401(k) plan fiduciaries from liability when the plan's company stock investment lost money. Under Dudenhoeffer, 401(k) fiduciaries are responsible for monitoring and evaluating company stock investments to the same extent they're responsible for reviewing other plan investments, Erin Turley, an employee benefits partner in McDermott Will & Emery's Dallas office, told Bloomberg Law.

Because Dudenhoeffer removed special legal protections covering company stock investments, the case increased the tension felt by many 401(k) fiduciaries, Turley said.

"One challenge that's always present with company stock is that individuals responsible for making decisions about whether the investment is prudent may at times have sensitive and confidential information that puts them in a bit of the crosshairs," Turley said. "As a corporate officer they have information regarding the performance of the company but may be constrained by corporate fiduciary duties from sharing this information and further constrained by insider trading securities laws from acting on non-public or confidential information to eliminate some or all of the company stock from the plan. So what do you do if you're in that position?"

Limiting a 401(k) plan's company stock holdings may be an attempt to better fulfill the fiduciary obligations announced by Dudenhoeffer, according to Turley.

Litigation, Maybe. Liability? No

Another factor forcing companies to rethink employer stock investments could be the litigation risk it poses. Dozens of companies that offer employer stock in their 401(k) plans have been sued over the past several years when stock prices have declined.

These lawsuits, which are filed under the Employee Retirement Income Security Act, began in earnest after the 2001 Enron Corp. scandal, which left workers with depleted retirement accounts after the company's stock price tanked. Some of the companies targeted more recently include JC Penney, Whole Foods, Exxon Mobil, Target Corp., RadioShack, and Eaton Corp.

Although the risk of a lawsuit is real, the risk of facing legal liability over a company stock investment has declined to the point of being almost negligible. After Dudenhoeffer and the 2016 follow-up decision in Harris v. Amgen Inc., virtually no lawsuit challenging the employee stock ownership plan (ESOP) component of a 401(k) plan has succeeded. Companies that have defeated stock-drop claims since 2014 include SunEdison, Wells Fargo, Cliffs Natural Resources, Lehman Bros., Citigroup, JPMorgan, L-3 Communications, IBM, and Hewlett-Packard.

"I don't know exactly what's driving this trend, but it's certainly not because fiduciaries are afraid of legal liability, because lawsuits against ESOP fiduciaries have become incredibly difficult to maintain," Samuel Bonderoff told Bloomberg Law. Bonderoff is a partner with Zamansky LLC in New York who represents investors in securities fraud and ERISA cases.

Since the 2016 Amgen decision in particular, courts have degraded the fiduciary duty with employer stock to where "you can basically fulfill your fiduciary duty regarding an employer stock plan by doing absolutely nothing no matter what happens," Bonderoff said.

Education, Diversification

Another factor driving this move may be the growing realization that many workers don't understand the risks associated with investing significant retirement savings in their employer's stock, Kara W. Tedesco, a principal and employee benefits consultant in Milliman's Albany, New York, office, told Bloomberg Law.

"When it comes to how people are investing their account balances, I don't believe there's good education around what it means to be diversified," Tedesco said. "People are working longer and retiring later, and they're in charge of investing their own money in a 401(k). When a company is putting their stock in the plan, everybody wants a piece of that stock because it shows ownership and loyalty. But if an employee has too much stock in their account, there's also a downside if the stock isn't performing well in the marketplace."

When 401(k) plans make matching contributions in employer stock or fail to cap the amount of stock workers can own, it can lead to "serious over-concentration" in that one investment, Bonderoff said. Cutting down on these practices may be an attempt to encourage diversification and reduce the risks associated with investing in a single stock.

"I'm a plaintiffs' lawyer, so I'm skeptical that companies are doing this out of the goodness of their hearts," Bonderoff said. "But even if they're doing it for some other reason, in the long run it's probably good, if indeed the result is that employees end up with more diverse retirement portfolios."

What You Should Know About Your Plan's ERISA Fidelity Bond Coverage

As benefit plan auditors, common questions we receive from clients are – what does my ERISA fidelity bond cover? Who does it cover? And is the amount appropriate? The Employee Retirement Income Security Act of 1974 ("ERISA") requires that every fiduciary of an employee benefit plan and every person who handles funds or other property of such a plan, be bonded.

RISA bonding requirements can often be confusing, so it is important that all plan fiduciaries understand the requirements in order to make sure their current fidelity bond is in compliance with the current rules and regulations. Plans should have ERISA fidelity bond coverage from an approved provider as of the beginning of the plan reporting period with a coverage amount in accordance with the regulations.

Who needs to be covered?

As mentioned above, every fiduciary of an employee benefit plan and every person who handles funds or other property of a plan must be bonded. Examples include- plan fiduciaries, certain officers, employees, plan committees, service providers and plan vendors. It is important that plan sponsors and fiduciaries understand the parties involved and the functions which they perform, so that appropriate bonding can be obtained. Once it is determined who needs to be covered, it is important to identify what the permissible forms of bonds are.

What type of coverage do I need?

A fidelity bond is required under section 412 of ERISA. Often, fidelity bond insurance and fiduciary liability insurance are thought of as the same, yet they are very different in that one is required under ERISA rules and the other is optional.

Fidelity Bond Insurance – A fidelity bond is a requirement under ERISA which protects the participants of the plan from any loss by reasons of fraud or dishonesty (including theft, larceny, embezzlement, forgery and misappropriation) that are incurred as a result of the mismanagement of funds by persons employed at the plan sponsor or are plan fiduciaries. The retirement plan should be listed as a covered entity on the policy or there should be reference to the fact that the bond covers any ERISA plans that are sponsored by the employer, so long as each plan can recover the amount required by ERISA.

Fiduciary Liability Insurance – This coverage is neither required by nor subject to section 412 of ERISA. Fiduciary liability insurance protects the plan fiduciaries against losses caused by breaches of fiduciary responsibility and is not a substitute for a fidelity bond.

Which coverage is required to be disclosed on the Plan's annual Form 5500?

Per Form 5500 instructions, on Line 4e, plans must check "yes" and enter the aggregate amount of fidelity bond coverage for all policies. The instructions require that "the plan itself (as opposed to the plan sponsor or administrator) is a named insured under a fidelity bond from an approved surety covering plan officials and that protects the plan from losses due to fraud or dishonesty as described in 29 CFR Part 2580". The instructions also go on to state that plans are permitted under certain conditions to purchase fiduciary liability insurance, however these fiduciary liability insurance policies are not written specifically to protect the plan from losses due to dishonest acts and cannot be reported as fidelity bond coverage on line 4e.

How much coverage do I need?

The amount of the bond per 29 CFR Part 2580, subpart C, states that the bond limit required for each person must be at least equal to 10% of the plan assets handled in the previous year, subject to a minimum of $1,000 or maximum of $500,000. The maximum amount increases to $1,000,000 for plans that hold employer securities, unless those investments are part of a "pool" such as mutual or index funds.

Is my provider an approved provider?

There is an exemption allowing plan officials to purchase bonds from surety companies authorized by the Secretary of the Treasury as acceptable reinsurers on federal bonds, see 29 CFR 2580.412-23. For a list of approved sureties and reinsures, see Department of the Treasury's Listing of Certified Companies, here.

As you can see, ERISA bonding requirements are quite voluminous and complex, so it is important that all plan sponsors and fiduciaries understand the rules in order to make sure their most recent fidelity bond is in compliance with the current rules and regulations. We recommend that all plan sponsors and fiduciaries review their coverage on an annual basis to make sure that they have ERISA fidelity bonding in effect from by approved provider as of the beginning of the plan reporting period and for the proper amount.

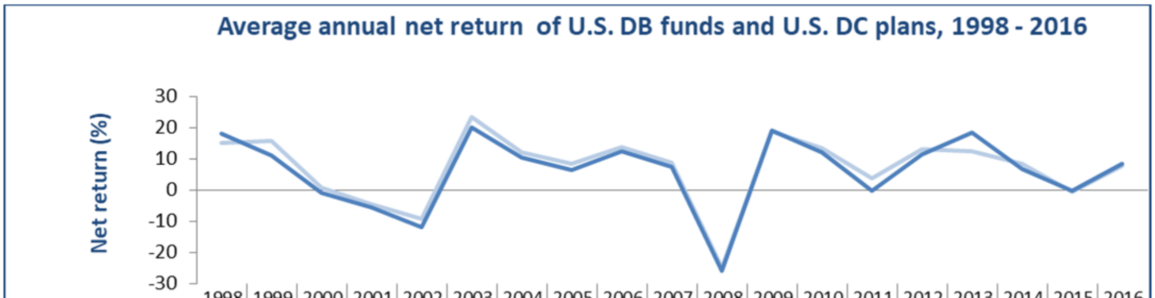
DEFINED CONTRIBUTION PLANS HAVE COME A LONG WAY!

In this update of an earlier CEM research article comparing DB and DC performance, you will find the net return difference between DB and DC plans has greatly decreased because of:

- Improved DC asset mix
- Improved DC plan design: more automatic enrollment and better default option
- Lower DC cost

1 Past performance of DB and DC pension plans

CEM has been collecting data on DB and DC plans since 1991 and 1997, respectively. As calculated in our 2006 study, DB funds outperformed DC plans from 1998-2005, by 1.80% (Flynn and Hubert, 20061). A return difference that in 25 years would result in a 34% smaller account value for the DC participant compared to the account value of the DB participant that started with the same dollar amount. However, in the last ten years, this margin has decreased considerably. This paper discusses why.



	1998	1999	2000	2001	2002	2003	2004	2005	2006	2007	2008	2009	2010	2011	2012	2013	2014	2015	2016
U.S. DB funds	14.9	15.7	0.7	-4.5	-9.4	23.2	12.0	8.4	13.8	8.6	-24.9	18.8	13.4	3.8	13.0	12.4	8.5	-0.6	7.7
U.S. DC plans	18.0	11.2	-1.0	-5.8	-12.0	20.1	10.4	6.3	12.3	7.4	-26.0	19.2	11.9	-0.2	11.3	18.5	6.9	-0.3	8.5
Difference	-3.1	4.5	1.6	1.3	2.6	3.1	1.6	2.1	1.5	1.2	1.2	-0.4	1.5	4.0	1.6	-6.0	1.7	-0.3	-0.8

2 DB and DC performance over the last 10 years

There have been many new developments in the DC world since CEM wrote the 2006 paper, so we thought it was time for an update. Below (table 1) is a comparison of the last 10 years.

Table 1: DB versus DC Performance, 2007 - 2016, U.S. Universe

	DB (10-yr avg)	DC (10-yr avg)	Difference (DB-DC)
Total return	5.96%	5.28%	0.68%
- Costs	0.60%	0.39%	0.22%
=Total net return	5.36%	4.89%	0.46%

DB funds outperformed DC plans by 0.46% from 2007-2016, a substantial narrowing of the gap from the 1.80% net return difference from 1998-2005. These findings were based on 1,967 observations in our U.S. DB database and 1,647 observations in our U.S. DC database. Total 2016 participant assets were $3.6 trillion from 168 U.S. DB funds and $1.0 trillion from 147 U.S. DC plans.

What has changed since we last compared DB and DC plan performance?

3 DC plans' asset mix has improved

The 2006 paper identified asset mix as the main driver of the underperformance of DC plans. Specifically, 8-year (1998-2005) average holdings of cash, stable value and company stock of 41% compared to the corresponding 8-year average of 1% for DB plans. Allocation to these lower expected return asset classes, in the case of cash and stable value, or an undiversified asset, in the case of company stock, have decreased. In 1998, these assets represented on average 44% (26% company stock + 18% stable value & cash) of the holdings in the DC plans. In 2016, they represent 25% (10% company stock and 15% stable value & cash), a sizable reduction. See Table 2 below for more details.

Table 2. Average asset mix U.S. DC plans

Asset Type	1998	2016
Stocks	37%	38%
Company Stock	26%	10%
Target and Balanced	15%	26%
Fixed Income	3%	7%
Stable Value & Cash	18%	15%
Other	1%	4%
Total	100%	100%

These allocations have mainly moved to Target Date and Balanced funds. Target Date Funds in particular have exploded in popularity. In 2007, 46% of the plans in our DC database offered Target Date Fund, compared to 87% in 2016. In addition to the benefit of an asset mix that changes automatically with time horizon to retirement, Target Date Funds also provide a much more diversified asset mix.

4 Changes in plan design

Behavioral economic studies have shown that plan participants are often overwhelmed by the amount of decisions they need to make in a DC plan. Thus, participants will overwhelmingly choose the default option (the option that contributions will be invested in unless the participant chooses otherwise) and if automatically enrolled in the default option, it is unlikely that these assets will be moved because of inertia (Beshears et al., 20062).

Many DC plan sponsors have taken these lessons to heart and have made plan design changes to help plan participants make more informed and better decisions.

4.1 More automatic enrollment

One plan design change; more plan sponsors are offering automatic enrollment in both primary plans(where the DC plan is the sole retirement vehicle) and supplemental plans (where the DC plan is in addition to a DB plan) as shown on Table 3.

Table 3. Automatic enrollment in U.S. DC plans

	2007	2016
Primary Plans (%)	62%	80%
Supplemental Plans (%)	51%	70%

4.2 Better default option

Another plan design change is more plan sponsors have a default option. In 2016 only 5% of DC plans in our database did not have a default option, down from 21% in 2007. Table 4 shows the type of default option offered by plans in our database. Target Date Fund is the most popular default option with 84% of plans in our database choosing this as their default option compared to 30% in 2007. The biggest asset mix improvement would be realized by plans that previously had a default option that was in the category of GICs/Stable Value/Cash. By 2016 only 1% still have this asset category as their default option, down from 21% in 2007. Target Date Fund provides a diversified asset mix which evolves automatically as the plan participant nears retirement.

Table 4. Type of default option

Option type	2007	2016
GICs/Stable Value/Cash	21%	1%
Balanced Funds	25%	7%
Target Date Funds	30%	84%
Other	3%	3%
No default	21%	5%
Total	100%	100%

These plan design changes will likely mean that the return difference between DB and DC plans will continue to reduce in the future.

5 Lower DC cost

In contrast to the 2006 study, costs had a notable impact on the difference between the total net returns. As shown in table 1, average DB plan costs were 0.60%, a 0.21% increase from the average cost of 0.39% observed during the initial 8-year period (1998-2005). Average DC plan costs have not increased, and hence cost differences contributed to the observed decrease in the net return difference between the two plan types.

Costs for DB plans have risen primarily because they are increasingly adopting more sophisticated investment strategies including a higher allocation to more expensive ‘alternative’ private market strategies such as private equity, venture capital, and hedge funds. For U.S. DB plans, combined policy weights for real assets, private equity and hedge funds increased from 14% in 2007 to 23% in 2016. In comparison, less than 1% of DC plan assets were directly invested in ‘alternative’ assets in our 2016 database. As a rule of thumb, the cost of alternative investment strategies range between 2X - 10X the cost of traditional public market active strategies.

Furthermore, DC plan sponsors have embraced low cost indexed options. By 2016, 58% of the indexable assets were indexed versus 40% in 1998. Why have DC costs not decreased more given the substantial increase in lower cost indexed options? Because as discussed previously, DC plans' asset mix have also changed, as participants have reduced their holdings of lower cost assets such as cash and company stock and moved to Target Date Fund.

Table 5 shows the cost difference between indexed and active mandates for investment options in our database. Of course, active management has the potential to generate higher returns compared to index funds and hence, paying more may pay off in the long run.

Table 5. Average cost for U.S. DC plans in 2016

Investment option type	Indexed	Active
Stock U.S. Broad / Large Cap	0.03%	0.42%
Stock U.S. Small Cap	0.05%	0.65%
Stock U.S. Mid Cap	0.05%	0.62%
Stock Non U.S. & Global	0.08%	0.58%
Bonds	0.05%	0.31%
Target & Balanced	0.09%	0.36%

6 Conclusion

DC plans have come a long way! The changes plan sponsors have made such as offering Target Date Fund, automatic enrollment and making Target Date Fund the main default option have reduced the net return differential between DB and DC plans. DC plans have become better retirement savings vehicles than we thought they would be just a decade ago. This is good news for DC plan participants.

www.cembenchmarking.com