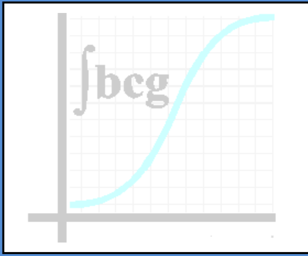

BCG Retirement News Roundup

August 2019 Volume 8, Issue 6

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

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

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

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Public Sector/Government Plans

Oregon Government Employees Sue to Overturn New State Pension Law

Nine Oregon public employees, including a Salem firefighter, have sued the state, saying their pension benefits are unfairly reduced by a new law.

The lawsuit, filed Friday in the Oregon Supreme Court, contests Senate Bill 1049, which the Oregon Legislature passed and Gov. Kate Brown signed into law this year. The lawsuit says that the legislation amounts to a breach of contract and illegal taking because it reduces the amount of retirement benefits for the employees.

SB 1049 was passed by lawmakers in a bid to rein in the state's unfunded pension liability tied to the Public Employees Retirement System, which is about $27 billion. Policymakers have long grappled with how to keep those costs under control, which are tied to the pensions of local, state and school district retirees.

The bill didn't pass the Legislature easily.

In the House, it squeaked by with a razor-thin two-vote margin. Lawmakers argued about the bill's affect in redirecting 2.5% of salaries toward PERS and trimming secondary retirement accounts.

The secondary accounts are similar to 401(k) plans and supplement traditional public pensions.

A spokeswoman for Senate President Peter Courtney, D-Salem, declined to comment Friday, because it's active litigation. Chris Pair, a spokesman for the governor's office, didn't respond to a request for comment. House Speaker Tina Kotek, D-Portland, was unavailable for comment.

Analysts: Oregon GOP recall of Gov. Brown unlikely to work, could serve other goals

The lawsuit says each employee's individual retirement account will lose from nearly 5% to 14% under the law.

For plaintiff Brandon Silence, a captain in the Salem Fire Department, it amounts to a 4.9% loss, or about $26,000 in retirement benefits.

"It's a breach of contract," Silence told the Statesman Journal. "These are benefits that were promised to us."

The lawsuit calls the law an "Illegal taking without compensation," and the plaintiffs say it reduces their retirement security.

“The plaintiffs and all PERS members accepted a job in good faith for a salary and benefits package, did the work they promised to do, and planned their futures based on the package they agreed to accept," said Aruna Masih, the plaintiffs' lead attorney.

Her firm, Bennett Hartman Attorneys at Law, has successfully challenged other cuts to the state's pension system dating back to 2005. In a 2015 case the firm handled, Silence was also plaintiff and successfully challenged pension benefit cuts.

"Their service for public employers creates certain contract rights to retirement benefits," Masih said. "As the Oregon Supreme Court has ruled in the past, the state cannot breach the terms of those contractual promises."

Other plaintiffs include a Molalla River School District secretary, a Lebanon state employee, a Portland water mechanic, a state child welfare worker, a Multnomah County nurse and a Multnomah County prosecutor. All are union members and their lawsuit is supported by the Keep Oregon's Promise Coalition, which fights efforts to trim pension benefits.

The case begins in the Oregon Supreme Court because the legislation has a provision that any challenges would start in the upper court.

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What Is the Maximum Possible Social Security Benefit in 2019

Here’s what you need to do to get Social Security payments for $3,000 per month or more.

THE AVERAGE MONTHLY Social Security payment for retirees was $1,471 in June 2019. But many retirees receive over $2,000 per month from the Social Security Administration, and payments could be as much as $3,770 in 2019.

The maximum possible Social Security benefit in 2019 depends on the age you begin to collect payments and is:

- $2,209 at age 62.
- $2,861 at age 66.
- $3,770 at age 70.

However, qualifying for payments worth $3,000 or more requires some serious career planning throughout your life. Here's what you need to do to qualify for the maximum possible Social Security payment.

Start Social Security Payments at Age 70

The maximum Social Security benefit changes based on the age you start your benefit. Those who postpone claiming Social Security between ages 62 and 70 become eligible for higher payments with each month of delay. For example, someone who signs up for Social Security at age 66 in 2019 could be eligible for as much as $2,861 per month. A person who claims payments at age 62

in 2019 has a smaller maximum possible benefit of $2,209 monthly. Only those who delay claiming past age 66 are eligible for Social Security payments of over $3,000 per month. A high earner who enrolls at age 70 could get a maximum Social Security benefit of $3,770 each month.

Consistently Earn a High Salary

You will need to maintain a high income throughout your career to qualify for large Social Security payments in retirement. In recent years, you need to earn a six-figure salary to get a top Social Security payment.

The maximum wage taxable by Social Security is $132,900 in 2019. However, the exact amount changes each year and has increased over time. It was $128,400 in 2018 and $106,800 10 years ago in 2009. Back in 1999, the taxable maximum was just $72,600. Only $37,800 was taxed by Social Security 35 years ago in 1984.

Workers pay 6.2% of their earnings into the Social Security system, and employers match this amount until their salary exceeds the taxable maximum amount of income for that year. Those who have salaries larger than the taxable maximum do not pay Social Security taxes on that income or have those earnings factored into their future Social Security payments. "In order to receive the maximum Social Security benefit, you would need to earn at least the maximum Social Security wage base for at least 35 years in your career," says Jim Blankenship, a certified financial planner for Blankenship Financial Planning in New Berlin, Illinois, and author of "A Social Security Owner's Manual." "The figure is adjusted each year based on changes to the national average wage index."

If you earn more than the taxable maximum amount in a single year, you won't have to pay Social Security taxes on that income. However, that income also won't be used to calculate your Social Security payments.

Earn the Social Security Taxable Maximum for 35 Years

You need to earn at least the taxable maximum each year for 35 years to get the maximum possible Social Security payment. If you don't work for 35 years, zeros are averaged into your calculation and will decrease your Social Security payments. "Whether because of a layoff or choosing not to work, these years of low or no income will ultimately impact the benefit you receive," says William Meyer, CEO of Social Security Solutions, a company that analyzes Social Security claiming strategies. "If you are laid off, find a part-time or lower-wage job. Even if it's temporary, your earnings will likely count toward your future benefit and will prevent a zero from being used in the calculation."

If you work for more than 35 years, a higher-earning year will replace a year when you earned less in the Social Security calculation. You can increase your Social Security payments even after you retire if you earn more now than you did earlier in your career. "Your benefits, after inflation, will keep rising if you work past 60 because of Social Security's annual recomputation of benefits," says Laurence Kotlikoff, an economics professor at Boston University and co-author of

"Get What's Yours: The Secrets to Maxing Out Your Social Security." "You can be 100, earn above the ceiling, and the next year you'll get a real benefit hike."

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Here's How Much Your State Spends on Retirement

Every day, an estimated 10,000 Americans baby boomers retire – and unfortunately many of them will spend their golden years pinching pennies. According to a recent estimate released by the U.S. Government Accountability Office, nearly half of all Americans 55 and older have no retirement savings.
Still, despite having no retirement savings, many retirees are expected to be relatively financially secure over the course of their retirement. In addition to monthly Social Security payments, millions of older retired Americans – including former teachers, firefighters, police officers, and other state and local government employees – are also expected to receive pensions.

According to the U.S. Census Bureau's 2017 Annual Survey of Public Pensions, state and local governments contributed $144.6 billion to employee pension programs in 2017. Not all states, however, spend equally on retirement programs. 24/7 Wall St. reviewed annual pension fund contributions at the state and local level to identify the states that are spending the most to fund their residents' retirement. States are ranked based on total 2017 pension fund contributions per current state and local government employee.

The states spending the most per public sector worker do not necessarily have greater than average public sector employment. In fact, Alaska and Hawaii are the only two states in the top 10 on this list to also rank among the 10 states where the most people work for the government.
While public pensions are a financial lifeline to millions of Americans heading into retirement, they are costly – and most state pension systems are woefully underfunded. In 20 states, less than two-thirds of pension obligations have adequate funding. Some of the states spending the most on retirement in 2017 also have the largest funding gaps to close.

50. South Dakota
- **2017 state and local gov't pension contributions:** $2,107 per gov't worker
- **Pension obligations funded:** 100.1% (2nd highest)
- **Workers in state and local gov't:** 67,700 (15.6% of labor force)
- **65 and older population:** 141,886 (16.3% of total)

49. Wyoming
- **2017 state and local gov't pension contributions:** $2,822 per gov't worker
- **Pension obligations funded:** 75.9% (23rd highest)
- **Workers in state and local gov't:** 62,400 (22.0% of labor force)
- **65 and older population:** 90,437 (15.6% of total)

48. Wisconsin
- **2017 state and local gov't pension contributions:** $2,883 per gov't worker
- **Pension obligations funded:** 102.6% (the highest)
- **Workers in state and local gov't:** 378,400 (12.8% of labor force)
- **65 and older population:** 956,184 (16.5% of total)

47. North Carolina
- **2017 state and local gov't pension contributions:** $2,992 per gov't worker
- **Pension obligations funded:** 90.7% (6th highest)
- **Workers in state and local gov't:** 657,600 (14.9% of labor force)
- **65 and older population:** 1.6 million (15.9% of total)

46. Nebraska
- **2017 state and local gov't pension contributions:** $3,009 per gov't worker
- **Pension obligations funded:** 90.2% (8th highest)
- **Workers in state and local gov't:** 156,300 (15.3% of labor force)
- **65 and older population:** 294,905 (15.4% of total)

45. North Dakota
- **2017 state and local gov't pension contributions:** $3,020 per gov't worker
- **Pension obligations funded:** 63.8% (16th lowest)
- **Workers in state and local gov't:** 73,300 (17.0% of labor force)
- **65 and older population:** 112,669 (14.9% of total)

44. Iowa
- **2017 state and local gov't pension contributions:** $3,325 per gov't worker
- **Pension obligations funded:** 82.3% (12th highest)
- **Workers in state and local gov't:** 242,400 (15.4% of labor force)
- **65 and older population:** 524,624 (16.7% of total)

43. Idaho
- **2017 state and local gov't pension contributions:** $3,346 per gov't worker
- **Pension obligations funded:** 91.3% (5th highest)
- **Workers in state and local gov't:** 110,200 (15.4% of labor force)
- **65 and older population:** 262,594 (15.3% of total)

42. Vermont
- **2017 state and local gov't pension contributions:** $3,482 per gov't worker
- **Pension obligations funded:** 64.3% (17th lowest)
- **Workers in state and local gov't:** 49,300 (15.7% of labor force)
- **65 and older population:** 117,150 (18.8% of total)

41. Minnesota
- **2017 state and local gov't pension contributions:** $3,510 per gov't worker
- **Pension obligations funded:** 63.3% (15th lowest)
- **Workers in state and local gov't:** 391,400 (13.3% of labor force)
- **65 and older population:** 858,904 (15.4% of total)

40. Tennessee
- **2017 state and local gov't pension contributions:** $3,552 per gov't worker
- **Pension obligations funded:** 96.5% (3rd highest)
- **Workers in state and local gov't:** 381,300 (12.7% of labor force)
- **65 and older population:** 1.1 million (15.9% of total)

39. Montana
- **2017 state and local gov't pension contributions:** $3,561 per gov't worker
- **Pension obligations funded:** 72.8% (25th highest)
- **Workers in state and local gov't:** 77,800 (16.5% of labor force)
- **65 and older population:** 190,216 (18.1% of total)

38. Alabama
- **2017 state and local gov't pension contributions:** $3,997 per gov't worker
- **Pension obligations funded:** 70.9% (25th lowest)

• **Workers in state and local gov't:** 331,500 (16.4% of labor force)
• **65 and older population:** 803,216 (16.5% of total)

37. Texas
• **2017 state and local gov't pension contributions:** $4,014 per gov't worker
• **Pension obligations funded:** 76.1% (22nd highest)
• **Workers in state and local gov't:** 1.7 million (14.2% of labor force)
• **65 and older population:** 3.5 million (12.2% of total)

36. South Carolina
• **2017 state and local gov't pension contributions:** $4,170 per gov't worker
• **Pension obligations funded:** 54.3% (7th lowest)
• **Workers in state and local gov't:** 332,400 (15.9% of labor force)
• **65 and older population:** 865,817 (17.2% of total)

35. Oklahoma
• **2017 state and local gov't pension contributions:** $4,322 per gov't worker
• **Pension obligations funded:** 77.9% (18th highest)
• **Workers in state and local gov't:** 300,700 (18.1% of labor force)
• **65 and older population:** 601,132 (15.3% of total)

34. Florida
• **2017 state and local gov't pension contributions:** $4,330 per gov't worker
• **Pension obligations funded:** 79.3% (15th highest)
• **Workers in state and local gov't:** 966,700 (11.3% of labor force)
• **65 and older population:** 4.2 million (20.1% of total)

33. Oregon
• **2017 state and local gov't pension contributions:** $4,344 per gov't worker
• **Pension obligations funded:** 83.1% (10th highest)
• **Workers in state and local gov't:** 281,700 (15.0% of labor force)
• **65 and older population:** 708,868 (17.1% of total)

32. Colorado
• **2017 state and local gov't pension contributions:** $4,429 per gov't worker
• **Pension obligations funded:** 47.1% (5th lowest)
• **Workers in state and local gov't:** 383,100 (14.4% of labor force)
65 and older population: 773,699 (13.8% of total)

31. Maine
• **2017 state and local gov't pension contributions:** $4,477 per gov't worker
• **Pension obligations funded:** 81.9% (13th highest)
• **Workers in state and local gov't:** 84,900 (13.6% of labor force)
• **65 and older population:** 266,741 (20.0% of total)

30. Arkansas
• **2017 state and local gov't pension contributions:** $4,552 per gov't worker
• **Pension obligations funded:** 76.9% (21st highest)
• **Workers in state and local gov't:** 191,200 (15.3% of labor force)
• **65 and older population:** 497,024 (16.5% of total)

29. New Mexico
• **2017 state and local gov't pension contributions:** $4,654 per gov't worker
• **Pension obligations funded:** 62.5% (13th lowest)
• **Workers in state and local gov't:** 158,100 (19.0% of labor force)
• **65 and older population:** 349,929 (16.8% of total)

28. Washington

• **2017 state and local gov't pension contributions:** $4,820 per gov't worker
• **Pension obligations funded:** 89.6% (9th highest)
• **Workers in state and local gov't:** 511,100 (15.4% of labor force)
• **65 and older population:** 1.1 million (15.1% of total)

27. Mississippi
• **2017 state and local gov't pension contributions:** $4,842 per gov't worker
• **Pension obligations funded:** 61.6% (11th lowest)
• **Workers in state and local gov't:** 217,300 (18.9% of labor force)
• **65 and older population:** 465,719 (15.6% of total)

26. Delaware
• **2017 state and local gov't pension contributions:** $4,952 per gov't worker
• **Pension obligations funded:** 82.8% (11th highest)
• **Workers in state and local gov't:** 60,300 (13.2% of labor force)
• **65 and older population:** 173,217 (18.0% of total)

25. Indiana
• **2017 state and local gov't pension contributions:** $5,011 per gov't worker
• **Pension obligations funded:** 65.0% (18th lowest)
• **Workers in state and local gov't:** 390,200 (12.5% of labor force)
• **65 and older population:** 1.0 million (15.4% of total)

24. Georgia
• **2017 state and local gov't pension contributions:** $5,140 per gov't worker
• **Pension obligations funded:** 79.2% (16th highest)
• **Workers in state and local gov't:** 586,400 (13.2% of labor force)
• **65 and older population:** 1.4 million (13.4% of total)

23. Utah
• **2017 state and local gov't pension contributions:** $5,304 per gov't worker
• **Pension obligations funded:** 90.3% (7th highest)
• **Workers in state and local gov't:** 208,300 (14.2% of labor force)
• **65 and older population:** 335,195 (10.8% of total)

22. New Hampshire
• **2017 state and local gov't pension contributions:** $5,341 per gov't worker
• **Pension obligations funded:** 62.7% (14th lowest)
• **Workers in state and local gov't:** 82,600 (12.2% of labor force)
• **65 and older population:** 236,321 (17.6% of total)

21. Virginia
• **2017 state and local gov't pension contributions:** $5,475 per gov't worker
• **Pension obligations funded:** 77.2% (20th highest)
Workers in state and local gov't: 538,700 (13.6% of labor force)
• **65 and older population:** 1.3 million (15.0% of total)

20. West Virginia
• **2017 state and local gov't pension contributions:** $5,486 per gov't worker
• **Pension obligations funded:** 78.9% (17th highest)
• **Workers in state and local gov't:** 129,900 (18.2% of labor force)
• **65 and older population:** 350,572 (19.3% of total)

19. Missouri
• **2017 state and local gov't pension contributions:** $5,632 per gov't worker
• **Pension obligations funded:** 77.9% (18th highest)
• **Workers in state and local gov't:** 379,800 (13.2% of labor force)

• **65 and older population:** 1.0 million (16.5% of total)

18. Kansas

• **2017 state and local gov't pension contributions:** $5,671 per gov't worker
• **Pension obligations funded:** 67.1% (22nd lowest)
• **Workers in state and local gov't:** 231,100 (16.5% of labor force)
• **65 and older population:** 447,451 (15.4% of total)

17. Arizona

• **2017 state and local gov't pension contributions:** $6,027 per gov't worker
• **Pension obligations funded:** 62.2% (12th lowest)
• **Workers in state and local gov't:** 357,700 (12.9% of labor force)
• **65 and older population:** 1.2 million (17.1% of total)

16. Nevada

• **2017 state and local gov't pension contributions:** $6,410 per gov't worker
• **Pension obligations funded:** 74.4% (24th highest)
• **Workers in state and local gov't:** 141,600 (10.6% of labor force)
• **65 and older population:** 458,679 (15.3% of total)

15. Ohio

• **2017 state and local gov't pension contributions:** $6,719 per gov't worker
• **Pension obligations funded:** 80.1% (14th highest)
• **Workers in state and local gov't:** 701,900 (12.7% of labor force)
• **65 and older population:** 1.9 million (16.6% of total)

14. New Jersey

• **2017 state and local gov't pension contributions:** $6,740 per gov't worker
• **Pension obligations funded:** 35.8% (2nd lowest)
• **Workers in state and local gov't:** 552,300 (13.4% of labor force)
• **65 and older population:** 1.4 million (15.7% of total)

13. Michigan

• **2017 state and local gov't pension contributions:** $7,976 per gov't worker
• **Pension obligations funded:** 65.1% (20th lowest)
• **Workers in state and local gov't:** 551,100 (12.6% of labor force)
• **65 and older population:** 1.7 million (16.7% of total)

12. Massachusetts

• **2017 state and local gov't pension contributions:** $7,977 per gov't worker
• **Pension obligations funded:** 59.9% (10th lowest)
• **Workers in state and local gov't:** 406,600 (11.3% of labor force)
• **65 and older population:** 1.1 million (16.1% of total)

11. Maryland

• **2017 state and local gov't pension contributions:** $8,043 per gov't worker
• **Pension obligations funded:** 68.6% (23rd lowest)
• **Workers in state and local gov't:** 357,300 (13.1% of labor force)
• **65 and older population:** 902,586 (14.9% of total)

10. Alaska

• **2017 state and local gov't pension contributions:** $8,115 per gov't worker
• **Pension obligations funded:** 66.6% (21st lowest)
• **Workers in state and local gov't:** 66,000 (20.0% of labor force)
• **65 and older population:** 83,041 (11.2% of total)

9. Kentucky

• **2017 state and local gov't pension contributions:** $8,421 per gov't worker

• **Pension obligations funded:** 33.9% (the lowest)
• **Workers in state and local gov't:** 279,200 (14.5% of labor force)
• **65 and older population:** 709,048 (15.9% of total)

8. Hawaii
• **2017 state and local gov't pension contributions:** $8,507 per gov't worker
• **Pension obligations funded:** 54.8% (8th lowest)
• **Workers in state and local gov't:** 92,200 (14.1% of labor force)
• **65 and older population:** 253,750 (17.8% of total)

7. Louisiana
• **2017 state and local gov't pension contributions:** $8,937 per gov't worker
• **Pension obligations funded:** 65.1% (20th lowest)
• **Workers in state and local gov't:** 297,200 (15.1% of labor force)
• **65 and older population:** 696,111 (14.9% of total)

6. Pennsylvania
• **2017 state and local gov't pension contributions:** $12,068 per gov't worker
• **Pension obligations funded:** 55.3% (9th lowest)
• **Workers in state and local gov't:** 606,100 (10.2% of labor force)
• **65 and older population:** 2.3 million (17.8% of total)

5. California
• **2017 state and local gov't pension contributions:** $12,792 per gov't worker
• **Pension obligations funded:** 68.9% (24th lowest)
• **Workers in state and local gov't:** 2.3 million (13.8% of labor force)
• **65 and older population:** 5.5 million (13.9% of total)

4. New York
• **2017 state and local gov't pension contributions:** $12,880 per gov't worker
• **Pension obligations funded:** 94.5% (4th highest)
• **Workers in state and local gov't:** 1.7 million (14.3% of labor force)
• **65 and older population:** 3.2 million (15.9% of total)

3. Rhode Island
2017 state and local gov't pension contributions: $13,777 per gov't worker
• **Pension obligations funded:** 53.7% (6th lowest)
• **Workers in state and local gov't:** 49,900 (10.1% of labor force)
• **65 and older population:** 176,572 (16.7% of total)

2. Connecticut
• **2017 state and local gov't pension contributions:** $14,103 per gov't worker
• **Pension obligations funded:** 45.7% (4th lowest)
• **Workers in state and local gov't:** 220,500 (13.1% of labor force)
• **65 and older population:** 601,094 (16.8% of total)

1. Illinois
• **2017 state and local gov't pension contributions:** $15,562 per gov't worker
• **Pension obligations funded:** 38.4% (3rd lowest)
• **Workers in state and local gov't:** 747,700 (12.3% of labor force)
• **65 and older population:** 1.9 million (15.2% of total)

Methodology

To identify the states spending the most to fund their residents' retirement, 24/7 Wall St. reviewed total state and local government pension contributions in 2017. We adjusted that figure per state and local government worker using 2017 data. State and local government pension

spending came from the U.S. Census Bureau's 2017 Annual Survey of Public Pensions and public sector employment came from the Bureau of Labor Statistics. We also considered each state's pension funding ratio, which is the share of pension obligations that have funding from Pew Charitable Trusts, a public policy advocacy group. The share of the population 65 and older came from the U.S. Census Bureau's 2017 American Community Survey.

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California Court of Appeals Further Clarifies STRS' Authority to Collect Overpayments Made to Retirees

Over the last several years, the California Courts of Appeal have addressed questions regarding the California State Teachers' Retirement System's (CalSTRS) ability to collect overpayments of monthly retirement benefits paid to retirees because of, among other things, miscalculations of the retirees' compensation earnable. A Court of Appeal handed down the most recent case, Blaser v. State Teachers' Retirement System (2019) 37 Cal.App.5th 349 ("Blaser") last month.

Blaser, and other recent decisions, specifically addressed application of California Education Code section 22008's statute of limitations on CalSTRS' ability to collect overpayments previously made to retirees. Section 22008, a provision of the State Teachers' Retirement Law (the "STRL"), provides in relevant part that "no action may be commenced by or against the board, the system, or the plan more than three years after all obligations to or on behalf of the member, former member, beneficiary, or annuity beneficiary have been discharged."

The Blaser decision is a successor to a decision of a California Court of Appeal in Baxter v. State Teachers' Retirement System (2017) 18 Cal.App.5th 340 ("Baxter"), the facts of which are pertinent to understanding the issues adjudicated in Blaser. Baxter concerned a challenge by 11 retired teachers at the District (the "Baxter petitioners") to a CalSTRS audit. A CalSTRS audit had determined that the Baxter petitioners were overpaid in their retirement benefits as the result of the "improper inclusion of certain earnings in the calculation" of their retirement benefits. Specifically, the District's Collective Bargaining Agreement ("CBA") with the Salinas Valley Federation of Teachers treated teachers who taught an extra period as a separate class of employees; the CBA considered both classes of teachers – those who taught the extra period and those who did not – as having worked full-time. However, the audit determined that the teachers who taught the extra period actually worked more than full-time (i.e., in excess of 1,000 hours) and therefore, any additional hours worked due to the extra period should not have been counted as creditable compensation to the teachers' defined benefit plan. The Baxter petitioners appealed the audit findings according to the administrative appeals process under the STRL. The administrative appeal proceeding commenced when CalSTRS filed a "Statement of Issues," similar in nature to the commencement of lawsuit when the plaintiff files the complaint. The Court of Appeal held that it was the date on which CalSTRS filed the administrative Statement of Issues that stopped the three-year statute of limitations under section 22008. Thus, the Blaser court held that CalSTRS was precluded from recouping overpayments occurring more than three years

prior to the date on which CalSTRS filed the Statement of Issues initiating the administrative appeal.

However, because the 31 teachers at issue in Blaser were not identified in the original CalSTRS audit as among the sample of employees whose compensation earnable was misreported, they were not afforded the opportunity to file an administrative appeal before CalSTRS proceeded to reduce their future retirement allowances and recoup past overpayments. Therefore, the 31 teachers in Blaser filed petitions for writs of mandate in superior court seeking to prevent CalSTRS from recouping past overpayments and reducing further retirement allowances.
The Blaser Court made the following pertinent findings:

1. Applying standards outlined in Baxter, the “continuous accrual theory” allowed CalSTRS to collect from the Blaser Teachers only those monthly overpayments made to the retirees within the three years prior to commencement of the action; any overpayments made to the Blaser Teachers more than three years prior to commencement of the action were time barred by Section 22008’s limitation’s period.
2. The action in this case was “commenced” when the Blaser Teachers filed petitions for writs of mandate in superior court. Thus, because the plaintiffs did not have an opportunity for an administrative appeal, the statute of limitations was not tolled until the plaintiffs sought relief in another forum.
3. Application of the continuous accrual theory applies whether or not the Blaser Teachers intended to act “wrongfully” in collecting the overpayments. For purposes of the application of the statute of limitations, even if the Blaser Teachers reasonably believed their extra-period earnings was appropriately included as creditable compensation, the “wrongful act” was that the Blaser Teachers received payments to which they were not legally entitled.
4. While the Blaser Teachers held a vested right to properly calculated retirement benefits, they held no vested right in excess payments based upon incorrect calculations.

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Enduring Challenges - Examining the Experiences of States that Closed Pension Plans

EXECUTIVE SUMMARY

The overwhelming majority of state and local government employees continue to participate in defined benefit pension plans. A few states have closed their pension plans during the past couple of decades, placing their new hires in alternative plans like defined contribution or cash balance plans. This report features four case studies of states --Alaska, Kentucky, Michigan, and West Virginia-- that closed their pension plans in favor of an alternative plan design. The key findings of this report are as follows:

- Switching from a defined benefit pension plan to a defined contribution or cash balance plan did not address existing pension underfunding as promised. Instead, costs for these states increased after closing the pension plan.
- Responsible funding of pension plans is key to managing legacy costs associated with these plans. The experience of these states shows that changing benefits for future hires does not address an existing funding shortfall.
- The change in plan design has resulted in greater retirement insecurity for employees. In West Virginia's case, this led the state to reopen the closed pension plan.
- Workforce challenges are emerging as a result of the benefit changes. Especially in Alaska, difficulties in recruiting and retaining public employees have increased since the pension plans were closed to new hires. The Alaska Department of Public Safety lists the ability to offer a defined benefit pension as a "critical need" for the department.

Each analysis examines the key issues and the impact of the plan change over time. Specific areas include: the impact on the overall demographics of the system membership; changes in the cost of providing benefits under the plan; the percent of the actuarially determined employer contribution made by the state and other public employers each year; the effect on the retirement security of workers impacted by the change; and the impact on the overall funding level of the plan over time. To the extent possible, the case studies also examine subsequent action taken by policymakers to address the results of the plan changes. A note on terminology: throughout this report, we will use the term "Actuarially Determined Employer Contribution (ADEC)," instead of the term "Annual Required Contribution (ARC)." Some of the comprehensive annual financial reports cited in this report still use the term ARC, but for consistency, we will use the term ADEC.

CASE STUDY: ALASKA FACES MOUNTING CHALLENGES THIRTEEN YEARS AFTER CLOSING PENSION PLANS

Closing the Plans Did Not Help Bring Down Underfunding

In 2005, the Alaska legislature closed its two statewide defined benefit pension plans for teachers and public employees. All new hires since July 1, 2006 participate in a defined contribution retirement plan. Since that time, it's become clear that the move to a defined contribution plan did not improve the funded status of the pension plans. Furthermore, public employees are facing increasing retirement insecurity, and there is emerging evidence the state is finding it more difficult to retain a quality workforce following the benefit change.

When the legislature passed the law that closed the defined benefit plans and created the defined contribution plans, the governor claimed the legislation would "slow down the state's increasing liability."[1] Instead, the past thirteen years have revealed a much more complicated outcome for the state.

Much of the political momentum behind closing the pension plans was driven by the state's unfunded liability, including the liability related to post-employment healthcare. In 2005, the state faced a combined $4.1 billion unfunded liability for pension benefits in the Public Employees Retirement System (PERS) and the Teachers Retirement System (TRS). The

underfunding of these plans was caused by a variety of factors, including poor funding decisions by elected officials, stock market declines, and significant actuarial errors.

Mercer Inc., the state's actuary, had made inaccurate actuarial projections and then attempted to hide them from the state. The firm had recommended the state contribute less to the plans than what was actually needed. This error alone contributed to $2.5 billion of the state's unfunded liabilities.[2] The state of Alaska sued in December 2007, seeking $2.8 billion in damages. Ultimately, Mercer and the State of Alaska settled for $500 million.[3]

By the time Alaska received the settlement in 2010, the damage had already been done. Governor Frank Murkowski had used the perceived crisis of the unfunded liability to push for the closing of the pension plans, and he had succeeded. The real problem Alaska faced in 2005 was a funding problem -- and closing the pension plans did not address that. In fact, in the years following the closing of the defined benefit plans, the Alaska legislature continued to underpay the actuarially determined employer contribution (ADEC).

Since the plans were closed in 2005, the state of Alaska has alternated between underpaying and overpaying the ADEC. As the chart below shows, Alaska underpaid the ADEC in PERS in 10 of the 14 years from 2005 through 2018, and in 8 of those years it underpaid the ADEC in TRS.[4] These poor funding practices belie the claim that the state acted in 2005 to address underfunding in the pension plans.

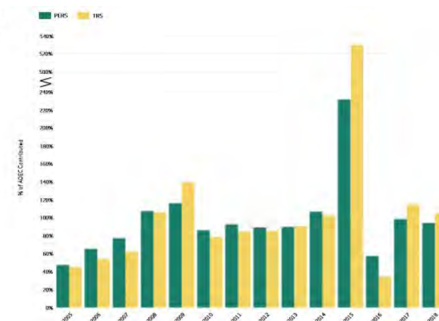


Figure 1. **Alaska ADEC Contributions by Plan**

Moreover, closing the pension plans made it more difficult for the state to manage the existing unfunded liability because new employees no longer pay into the system. As a result of the ongoing underfunding, the state decided to make a one-time $3 billion contribution to the closed pension plans in 2014.[5] Despite this significant infusion of the state's financial resources, the combined unfunded liability for pension benefits was higher in 2017 ($6.3 billion) than it was in 2005 ($4.1 billion). Closing the plans did not reduce the unfunded liability. Alaska has managed to improve the funded status of both plans modestly --from 65.7 percent to 66.7 percent in PERS and from 60.9 percent to 75.9 percent in TRS-- but this is due almost entirely to the $3 billion contribution. Meanwhile, the unfunded actuarial accrued liability for pension benefits has increased in both plans since 2005.

CLOSING THE PLANS CREATED RECRUITMENT AND RETENTION CHALLENGES FOR THE STATE

Closing the pension plans did have other repercussions. Since 2005, the state has experienced significant challenges recruiting and retaining public employees. Due to its unique and imposing geography, Alaska is already a difficult place to recruit public employees, especially teachers, who may spend months at a time in small, remote villages. While pay is generally higher than the national average in Alaska, the state also has a much higher cost of living, again, owing to its remoteness and unique geography. The lack of a defined benefit pension plan and competitive

benefits in general is often directly cited as a major reason why Alaska struggles to recruit teachers, state troopers, and other public employees.

In April 2019, nine former Alaska Teachers of the Year wrote an op-ed attributing the state's challenges recruiting and retaining teachers to the lack of a defined benefit pension.[6] "There is not a single financial reason for a teacher to remain longer than five years on a defined-contribution retirement plan," they wrote.[7] (Teachers in Alaska's defined contribution plan vest in their retirement benefits after five years.) They point out that many teachers are incentivized to teach for a few years in Alaska and then move to another state where they will receive a defined benefit pension. And replacing these teachers is expensive: The Center for Alaska Education Policy Research determines that it costs $20,431 per teacher when totaling all turnover costs (separation, recruitment, hiring, and induction and training).[8] As a result, the state of Alaska loses $20 million each year due to teacher turnover.[9]

The Alaska Department of Public Safety has experienced similar challenges. In a report to the state legislature, DPS officials cited the lack of a defined benefit pension as one of the primary obstacles to recruiting and retaining new state troopers.[10] Over the six year period from 2011 through 2017, the Alaska DPS saw a noticeable increase in the number of non-retirement separations from service. Seventy-two percent of those who left went to work for a different public safety department often in a state that offers a pension.[11] Given that it costs $190,000 and takes 12-18 months to train and certify a new state trooper, Alaska has strong incentives to retain experienced officers. The department identified the ability to offer a defined benefit pension to law enforcement officers in Alaska as a "critical need."[12]

CLOSING THE PLANS MADE THEM MORE "MATURE," THEREBY INCREASING COSTS

Meanwhile, as new teachers and public employees have joined the defined contribution plan over the past thirteen years, the balance between active and retired employees in the closed defined benefit plans has worsened. As of June 30, 2017, there were 14,719 active members in the PERS DB plan, compared to 34,347 retired members. In TRS, the equivalent numbers were 4,772 active members to 12,983 retired members. This imbalance between active and retired members --along with the resulting shorter investment time horizon and negative cash flow associated with closing a plan and spending down assets-- will force the plan to either adopt more conservative investments or take on more risk, because eventually it will no longer be managing a plan with very long investment time horizons. More conservative investments mean a lower assumed rate of return on plan assets, which typically increases costs.

Table 1. **Active and Retired members by Plan**

	DB Plan		**DC Plan**	
PERS	14,719 Active Members	34,347 Retired Members	19,171 Active Members	7 Retired Members*
TRS	4,772 Active Members	12,983 Retired members	4,694 Active Members	4 Retired Members

*Plus 14 disabilitiants and beneficiaries

If the defined benefit plans had remained open, the balance between active and retired members would be much better. If all the active members of the PERS DC plan were in the PERS DB plan, the balance between active and retired members would be 1:1. Under the same circumstances for TRS, the balance would be 2:3 rather than the current 1:3.[13]

THE EMPLOYEES IN THE DEFINED CONTRIBUTION PLANS ARE LIKELY TO EXPERIENCE GREATER FINANCIAL INSECURITY IN RETIREMENT

Teachers and some public employees in Alaska do not participate in Social Security. In the PERS defined benefit plan, the average annual pension benefit is $21,398; for peace officers and firefighters it is $35,629.[14] In the TRS defined benefit plan, the average annual benefit is $35,084.[15] These are modest benefits for retirees in a high cost of living state, many of whom will not receive Social Security benefits.

Many of the employees participating in the defined contribution plan will not have a guaranteed monthly income in retirement. This places those employees in a particularly precarious financial situation. Without Social Security to rely on, it is critically important that these workers maintain their account balances and find a reasonable and efficient way to spend down their assets in retirement.

The state of Alaska does not report annual account balances for participants in the defined contribution plans; however, by looking at the comprehensive annual financial reports, we calculated that the average account balance for a participant in the PERS DC plan is about $50,660.[16] There is a lot this number does not tell us. It could very well be the case that a small number of high earners are distorting the average account balance number. A median account balance number, if it were available, would go a long way toward better assessing the retirement readiness of these workers. Also, the value of the account balance varies significantly depending on the individual's age. For example, $50,000 at age 25 would be a great start toward saving for retirement, but at age 60, that amount would provide only a small amount of lifetime income.

One way to think about the challenges facing public employees and teachers in the defined contribution plan is to do a projection of future account balances and what pay replacement ratio that could generate. This study calculates that for an Alaska teacher who begins teaching at age 25 and retires at age 60, the defined contribution plan would generate a pay replacement ratio of 39 percent of final pay using the four percent rule to convert to annual lifetime income. This compares to 76 percent of final pay for the pension plan. After factoring in projected health care costs for a couple, the pay replacement ratio drops to 23 percent.[17] For workers who earn less during their career, the pay replacement after taking health care costs into account are worse because health care costs are not a function of income.

The career teacher in the example above has the highest projected pay replacement ratio. For teachers with shorter careers or for education support professionals, who typically earn lower salaries than teachers, their projected pay replacement ratios are even lower and may be insufficient to cover projected health costs in retirement. The above projections also assume steady returns of six percent per year, and that there is no major downturn in the financial

markets that wipes out a quarter of the value of the account (as happened to many in 2007-2008). It also assumes that the retired teacher draws down their resources according to the four percent rule, which is a rough rule of thumb for converting savings into retirement income.

Figure 2. **Alaska PERS Employer & State Contribution and Funded Status**

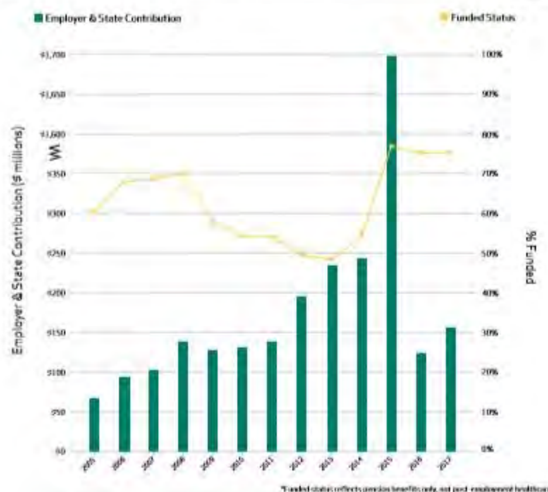


Figure 3. **Alaska TRS Employer & State Contribution and Funded Status**

One challenge Alaska is already experiencing is teachers and public employees in the defined contribution plan taking their money and leaving the state as soon as they vest after five years. According to the Alaska Retirement Management Board, through the third quarter of fiscal year 2019, 1302 PERS DC employees and 236 TRS DC employees have taken full disbursements from the funds.[18] This represents 70 percent and 77 percent, respectively, of total full disbursements for those two plans.[19]

In the years since closing its pension plans, Alaska has been on a rollercoaster. It has experienced a yo-yo effect of underpaying and then dramatically overpaying its ADEC. It made a massive one-time contribution to the pension plans to improve the funded status. What has it gotten from that? An unfunded liability that has grown since 2005 and very serious recruitment and retention challenges. In fact, even groups that often advocate for closing traditional defined benefit plans for public sector workers, such as the American Legislative Exchange Council (ALEC)[20] and Bellwether Education Partners,[21] have put Alaska at the top of various lists depicting states facing the most dire financial circumstances on retirement.

For all the money the state has spent, it finds itself in a worse financial position than it was in thirteen years ago. This does not even consider where the state will be in the future once teachers and public employees in the defined contribution plan without Social Security begin to retire. As of June 30, 2017, only 10 employees had retired from the two defined contribution plans. As the number of these retirees increases significantly in the years ahead, the state is likely to face increasing challenges caring for a retired population ill prepared for retirement.

Perhaps it is time that Alaska consider reopening the defined benefit plan to active employees, as the state of West Virginia did in 2005, after 14 unsuccessful years in a defined contribution

plan. Such a move would create greater financial security for Alaska's public sector workers, would help the state recruit and retain a quality workforce, and would likely help TRS and PERS dig out from their chronic underfunding.

CASE STUDY: SWITCH TO CASH BALANCE PLAN DID NOT ADDRESS THE TRUE CAUSE OF SEVERE UNDERFUNDING IN KENTUCKY PENSION PLAN

In March 2013, the Kentucky General Assembly passed Senate Bill 2, which established a new tier of benefits for plans in the Kentucky Retirement Systems (KRS). Public employees hired since January 1, 2014 participate in a cash balance hybrid plan instead of the defined benefit pension plan that public employees used to join. The move to a cash balance hybrid plan was sold as part of an overall push to improve the funding of KRS. Instead, as has been the case in other states that changed plan design, the switch did little to improve the funding level of KRS. The adoption of the cash balance hybrid plan was a distraction from the real issue in a state that has a history of underfunding its pension plans.

KRS consists of five different pension plans: Kentucky Employees Retirement System (KERS) Non-Hazardous; KERS Hazardous; County Employees Retirement System (CERS) Non-Hazardous; CERS Hazardous; and the State Police Retirement System (SPRS). While they all fall under the umbrella of KRS, each of these plans serves different groups of public employees. All of these plans suffer from low funding levels, but this case study will focus on KERS Non-Hazardous (KERS NH), as it has been an even more exceptionally underfunded plan.

FUNDING WAS ALREADY AN ISSUE BEFORE NEW TIER WAS CREATED

On June 30, 2013, just a few months after SB 2 passed, KERS NH had a funded ratio of 23.15 percent.[22] It is no wonder, then, that the General Assembly was concerned about the funded status of the plan. But the cause of the underfunding was hardly a mystery. From fiscal year 2006 through fiscal year 2014, KERS NH employers contributed roughly half or less of the actuarially determined employer contribution (ADEC).23 This chronic underfunding, coupled with the crippling effects of the financial crisis, gutted the funded status of KERS NH.

The funded status of KERS NH has dropped every year for at least the past fifteen years. In fiscal year 2004, KERS NH was funded at 85.1 percent.[24] By fiscal year 2018, the funded status was down to 12.88 percent.[25]

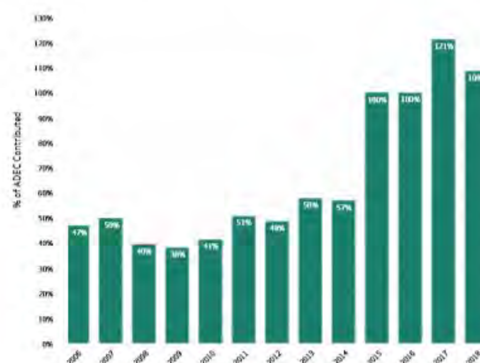


Figure 4. **ADEC Contributions to KERS NH**

While all KRS plans have seen a drastic decline in funding since the early 2000s, KERS NH has always had an even lower funded status than the other plans in KRS for all years in which data is available. In fiscal year 2004, KERS Hazardous was funded at 98.4 percent; CERS Non-Hazardous at 105.1 percent; CERS Hazardous at 88.8 percent; and SPRS at 88 percent.[26] By fiscal year 2018, these four plans had also seen their funded status drop: KERS H to 55.5 percent; CERS NH to 52.7 percent; CERS H to

48.4 percent; and SPRS to 27.1 percent.27 A large part of the reason why these plans have maintained a higher funded status than KERS NH is that their employer contributions have been more consistent, although SPRS has also experienced deep underfunding by the state.

UNFUNDED LIABILITY HAS CONTINUED TO RISE

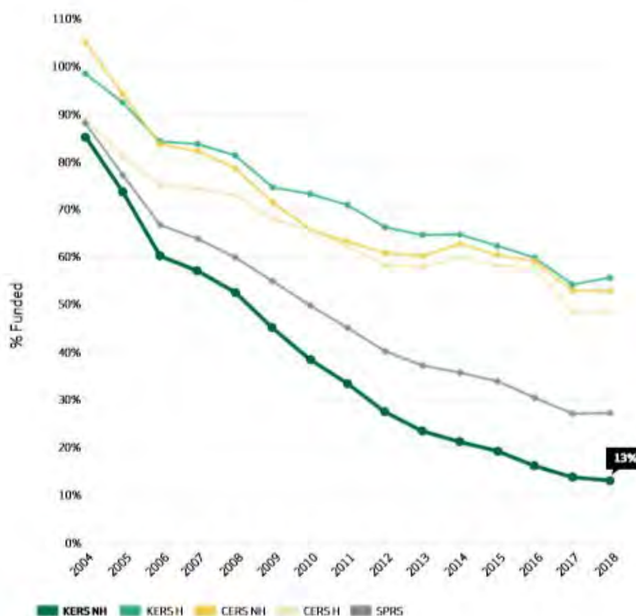


Figure 5. **Funded Status of KRS Plans**

As the funded status has declined, the unfunded liability has increased dramatically. In 2011, the unfunded liability in KERS NH was $7.5 billion. By 2018, that number had nearly doubled to $13.7 billion.[28] Interestingly, the actuarial accrued liability had only increased modestly over that time period, until the plan began to change assumptions in 2014. The significant increase in the accrued liability as of 2018 is due almost entirely to the decision by the KRS board to lower its discount rate (the assumed rate of return on investments) quite drastically over four years. The discount rate for KERS NH was reduced from 7.75 percent in 2014 to 7.5 percent in 2015, to 6.75 percent in 2016, and to 5.25 percent in 2017.[29] Given the way actuarial liabilities are calculated, lowering the discount rate will always increase a plan's liability. The reason for this change is that the plan adopted a more conservative investment strategy that recognized the need to reduce volatility and prioritize solvency given the funding levels.[30] (KRS does not use a discount rate this low for its three plans that are better funded.)

One of the main drivers of the increasing unfunded liability since 2011 has been a significant drop in the value of plan assets. KERS NH has been cash flow negative in six of the seven years from 2012 through 2018, meaning that the amount of benefits paid out each year has exceeded the amount of contributions made by members and employers.[31] An extremely low funded status coupled with a negative cash flow means that even a year of good investment returns will do little to improve the funded status of the plan. Negative cash flow, in and of itself, is not necessarily a problem. A well funded plan can recover from a market crash more quickly when investment returns rebound because the plan has more money (relative to liabilities) to invest. However, KERS NH is not in this situation. The combination of a large negative cash flow and poor funding makes this a particular problem for a plan already struggling with solvency concerns. It would be misleading to blame the underfunding on investment returns, however. As the financial markets recovered unevenly from the financial crisis, KRS and its plans experienced strong years as well as some years that fell short of expectations. KRS achieved investment returns of 15.55 percent for the year ending on June 30, 2014, but just two years later, the plan had a negative return of -0.52 percent and actually lost money through its investments.[32]

Despite these ups and downs, the system has still managed to achieve investment returns at or above its assumed rate of return over the five year period ending on June 30, 2018.33 Since the plan's inception, it has achieved returns above its assumed rate of return. However, with relatively few assets in the plan, investment returns can only go so far.

CHANGING BENEFITS FOR FUTURE HIRES DID NOT ADDRESS FUNDING ISSUES

When the Kentucky General Assembly was debating and passing SB 2 in the spring of 2013, it had already received the comprehensive annual financial report for KRS for the year ending June 30, 2012. That report showed that KERS NH had 100 percent of accumulated active member contributions, but only 25.4 percent of assets needed to cover the benefits owed to current retired members and beneficiaries.[34] And, there was no money for the employer share of costs for the current workforce. In short, there were large legacy costs that required funding. This is why switching future hires to a cash balance plan did little to improve the plan's solvency challenges. In fact, future hires' benefits, which garnered so much of the attention throughout the legislative process that produced the cash balance plan, would not meaningfully impact the plan's benefit payments for decades.

Like most new tiers adopted in recent years, the cash balance plan reduced the employer contribution to future hires' benefits. However, at this point, the legacy cost problem that existed in 2013 continues to be a much bigger part of the story than the cost of benefits in the new tier. As of June 30, 2018, members participating in the cash balance plan represent about one-third of active members in KERS NH, while the future benefits owed to all current workers only account for 24 percent of the plan's overall liabilities.[35]

As an alternative strategy, the state might have been better served by incentivizing those near retirement to work a few additional years and to delay benefit payments from a solvency-challenged system, instead of focusing on policies that would take decades to impact plan cash flows.

KRS reported in its 2018 Summary Annual Financial Report that its normal cost rate (the cost of currently accruing benefits) for employees in the KERS NH cash balance plan was only 2.5 percent.36 This may represent a meaningful future cost reduction for the state, but it comes at the cost of a less secure retirement benefit for employees.

The benefit earned through the cash balance plan is less secure than the benefit through the pension plan in several ways. The accumulated account balance in the cash balance hybrid plan is based upon four factors:

- An employer pay credit worth four percent of an employee's compensation,
- An employee contribution worth five percent of that employee's compensation,
- A base interest credit that represents a four percent interest rate, and an
- "Upside Sharing Interest" that is determined by a formula based on 75 percent of the plan's five year geometric investment return.

The Upside Sharing Interest is a variable benefit that changes from year to year. The cash balance hybrid plan also provides for a fixed life annuity at retirement based upon actuarial factors, but the plan itself notes that these actuarial factors could change in the future, making the annuity far less generous.37 Unlike the defined benefit pension plan, where benefits are determined by an established formula, participants in the cash balance hybrid plan can have little certainty what their benefit will be at retirement. Also, the benefit is likely to be far lower than what the traditional designs used to provide, particularly for people hired midcareer that have not saved a lot before joining the system.

THE STATE HAS BEGUN CONTRIBUTING FULL AMOUNT IN RECENT YEARS

The real accomplishment of SB 2 was requiring full payment of the ADEC beginning in 2015. So far, Kentucky has stuck to this commitment and has been contributing the full ADEC each year since. If this funding commitment continues, KRS should expect to see improved funding in the future. By this point, though, the plan is so severely underfunded that the newfound commitment to sound funding could not prevent the plan from struggling with solvency concerns, which has forced the plan to adopt less efficient investment strategies out of caution.

As KRS' funded status has continued to decline in the six years since SB 2 was passed, the General Assembly has tried to pass legislation to further reduce benefits for active employees, and establish yet another tier of lower benefits that would be a pure defined contribution plan. However, as this case study has explained, reducing benefits for active employees did virtually nothing to improve the funded status of KRS. Thus, it would be imprudent to double down on the same strategy again - especially since it comes at the expense of financial security for workers.

With an employer cost of only 2.5 percent of pay for workers in the KERS NH cash balance plan, further reductions in benefits could eliminate any state contribution or even require those in the cash balance plan to contribute toward paying off the state's legacy costs (if the employee's contribution eventually exceeds the value of their benefit).

Any future improvement in the funded status of KERS NH depends upon the state continuing to meet its commitment to fully fund the ADEC each year. Should the state return to its former practice of underfunding the ADEC, then the plan could face a true solvency crisis.

The recent history of the Kentucky Employees Retirement System Non-Hazardous plan offers a number of important lessons about how (and how not) to manage a pension plan.

It is a stark example of how important it is to contribute the full actuarially determined employer contribution each year. If those contributions are not made, then the plan will find itself falling deeper into a hole, as accrued benefits outpace assets to cover them. It also demonstrates that plan design changes do not solve a funding shortfall when the problem was not caused by plan design. Looking forward, Kentucky policymakers face a deep challenge in the years ahead as they work to improve the funded status of KERS NH.

While the state has made a positive change by contributing the full ADEC in recent years, it is clear that policymakers must maintain this commitment if the plan is to achieve meaningful

progress. The state cannot cut its way out of its funding problems by continuing to reduce retirement benefits for public employees.

APPENDIX ONE: AN UPDATE ON THE MICHIGAN STATE EMPLOYEES' RETIREMENT SYSTEM

The Michigan State Employees' Retirement System (SERS) pension plan has been closed for more than 22 years. All new hires since March 31, 1997 participate in a defined contribution plan rather than the SERS pension plan. However, there are still thousands of participating, active employees in the closed pension plan and tens of thousands of retirees collecting benefits from the plan. The closure of the defined benefit plan in Michigan SERS illustrates the long-term effects of closing a pension plan.

When the SERS defined benefit plan closed in 1997, the plan was actually overfunded with 109 percent of assets available to cover all liabilities ($734 million in excess assets, to be exact).[38] As of September 30, 2017, the plan was 66.5 percent funded and had an unfunded liability of $6 billion.[39] As the unfunded liability has grown, the assets available to cover the actuarial accrued liability (AAL) for retirees and beneficiaries has declined. SERS only had 82.5 percent of AAL covered by assets for retirees and beneficiaries in 2017. This is a decline from 100 percent covered as recently as 2010.[40]

The balance between active and retired members has shifted dramatically in the two decades since the plan has been closed. In 1997, there were 55,434 active members and 36,123 retirees and beneficiaries, or 1.5 active workers for each retiree.[41] By 2018, there were 9,473 active members compared to 60,010 retirees & beneficiaries.[42] This means there are now more than six retirees for every active worker - which can present challenges in managing a pension plan.

In 1997, the actuarially determined employer contribution (ADEC) was about $230 million.[43] By 2018, the required contribution had grown to $627 million.[44] The state of Michigan has been contributing nearly the full ADEC amount in recent years. Over the past ten years, the state has contributed 99.6 percent of the ADEC on average.[45] While this commitment to full funding should be lauded, the worsening plan demographics mean costs will remain high for the state and taxpayers. The state also contributed another $196 million to the State of Michigan Defined Contribution 401(k) and 457 plans, along with employee contributions of $227 million.[46]

There are currently 52,778 state of Michigan active employees participating in the 401(k) plan.[47] The state of Michigan does not include account balances for participants in the 401(k) plan in its annual financial report. Using data from the "State of Michigan 401(k) Plan Financial Report", NIRS calculated an average account balance of $87,433 per participant. Following the four percent rule, this balance would generate annual lifetime income of approximately $3,500 per year, or less than $300 per month. This compares to an average monthly benefit of $1,859 under the closed pension plan.

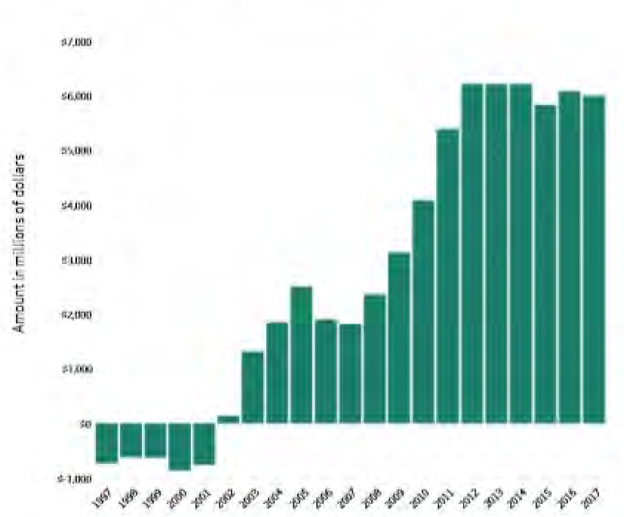


Figure 7. **Michigan SERS Unfunded Liability**

More than 20 years after closing the SERS pension plan, the state of Michigan has seen the unfunded liabilities in the plan increase. Meanwhile, the financial security of its public employees is at risk, as the defined contribution plan that replaced the SERS pension plan will provide far less income in retirement. Perhaps it is time that Michigan consider reopening the pension to active employees, as the state of West Virginia did in 2005, after 14 unsuccessful years in a defined contribution plan. Such a move would create greater financial security for Michigan's public sector workers and would likely help the SERS pension plan get back to full funding.

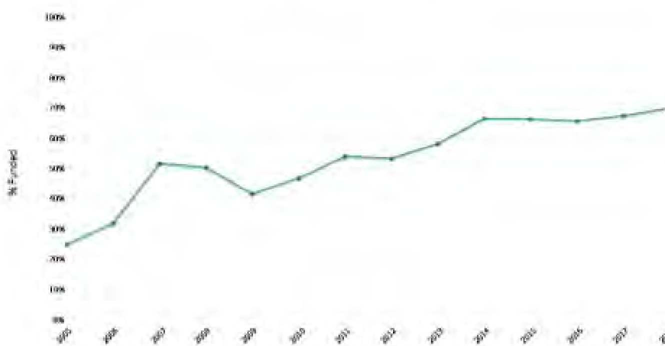
APPENDIX TWO: AN UPDATE ON THE WEST VIRGINIA TEACHERS' RETIREMENT SYSTEM

In 1991, West Virginia closed the Teachers' Retirement System (TRS), a defined benefit pension plan. In its place, new teachers began participating in a defined contribution plan. By the early 2000s, the state began studying the impact of this switch. The state found that if it returned to the defined benefit plan, it could provide equivalent benefits at half the cost of the defined contribution plan.[48] The state reopened the pension plan to new hires in 2005. Three years later, the state allowed teachers in the defined contribution plan to switch to the reopened pension plan; more than 78 percent did.[49]

When West Virginia reopened the pension plan in 2005, the funded status of the plan was just 25 percent.[50] The state has made steady and noticeable progress improving the funded status in the years since. After reopening the plan, the state made sizeable contributions to the plan in 2006 and 2007 in addition to its regular contributions. By 2008, the plan had already improved its funded status to 50 percent.[51] In 2018, the plan was 70 percent funded.[52]

West Virginia TRS offers a contrasting lesson to the states that closed their pension plans and have left them closed. Aside from a small dip during the financial crisis, West Virginia has been steadily reducing the unfunded liability in TRS each year. The unfunded liability has decreased from $4.1 billion on July 1, 2008 (just before the effects of the recession began) to $3.5 billion on July 1, 2017.[53] During this ten year period, the actuarial accrued liability has increased --because new members are joining the plan and earning benefits-- but the unfunded liability has decreased because the value of assets has increased at a faster rate than the accrued liability. The state has also contributed more than the actuarially determined employer contribution (ADEC) each year during this period.[54]

Figure 8. **West Virginia TRS Funded Status**



West Virginia TRS clearly demonstrates the importance of a sound funding policy. When evidence showed that the defined contribution plan was not working, the state followed the data and reopened the pension plan rather than pushing ahead with the defined contribution plan. Importantly, West Virginia committed to full funding after reopening the plan. That commitment, combined with the contributions of new members and positive investment returns, have allowed the plan to slash its unfunded liability.

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Private Sector

Defined Benefit Plan Actuarial Equivalence Litigation — A Formidable Threat or an Unfounded Theory?

A new wave of putative class-action lawsuits filed under the Employee Retirement Income Security Act of 1974 (ERISA) has emerged onto the scene alleging that companies are using outdated mortality tables from the 1970s and 1980s in calculating alternative forms of benefits under defined benefit plans. Starting with four lawsuits in December of 2018, there are now nine lawsuits, all filed by the same two plaintiff-side law firms against plan sponsors Metropolitan Life Insurance Company ("MetLife"), American Airlines, PepsiCo, U.S. Bancorp, Rockwell Automation, Anheuser-Busch, Huntington Ingalls Industries, Raytheon Company, and Partners Healthcare System, and the plans' fiduciaries.

All nine lawsuits generally allege that the plans used unreasonable actuarial assumptions when converting the plans' normal forms of retirement benefit such as a single life annuity, to an alternative form of benefit, such as a joint and survivor annuity. Essentially, plaintiffs allege that the alternative forms of benefit are not actuarially equivalent to the normal form of benefit as required under ERISA and, therefore, some retirees who are participants in the companies' defined benefit pension plans have lost part of their vested retirement benefits in violation of ERISA section 203(a). The plaintiffs also claim that the plans' fiduciaries breached their duties in using these alleged outdated mortality tables. Ultimately, the lawsuits seek reformation of the plans, payment of benefits pursuant to the reformed plan's terms, and payment of improperly calculated and withheld benefits.

Defendants in seven of the cases have filed motions to dismiss, but decisions have been reached in only two of these motions. The courts in Smith, et al. v. U.S. Bancorp (C.D. Minn.) and Torres, et al. v. American Airlines (N.D. Tex.) denied the defendants' motions to dismiss. While the plaintiffs may view these denials as victories, this does not indicate that the plaintiffs will prevail at the end of the day as litigation continues and actuarial experts are brought in. Moreover, there are still five motions to dismiss pending — which will likely increase to seven motions if the defendants in the two latest cases file such motions. Because this litigation is still in the early

stages, it is unclear how significant a threat these lawsuits may prove to be, but given the increase in the number of lawsuits filed and the spread of these cases among six circuits — the First, Second, Fourth, Fifth, Seventh, and Eighth Circuit — plan sponsors should take a close look at their plan document, specifically the interest rate and mortality table specified in the plan document.

Actuarial Equivalence in a Defined Benefit Plan

Under the Internal Revenue Code (IRC), the plan document for a defined benefit plan must specify the plan's normal form of benefit, which must be expressed in the form of an annuity commencing at normal retirement age.1 In most plans, the normal form of benefit is a single life annuity (SLA). In addition to the normal form of benefit, most defined benefit plans also offer a variety of alternative forms of benefit. Some of the more common alternative forms of benefit are the qualified joint and survivor annuity, certain and life annuities, and early retirement. Participants, regardless of the form of benefit they choose at retirement, accrue their benefit under the plan's normal form of benefit.[2] If a participant at retirement elects an alternative form of benefit, then the accrued normal form of benefit must be converted to the alternative form of benefit, which must have a present value that is actuarially equivalent to the plan's normal form of benefit.3 This conversion is accomplished through the application of the plan's actuarial assumptions that are based on mortality tables and interest rates (or a table of adjustment factors, e.g., early retirement factors), and those must be stated in the plan document.4 The actuarial assumptions are then used to determine a conversion factor which is applied to the normal form of benefit to calculate the value of the alternative form of benefit.

Summary of Defendants' Motions to Dismiss

While all of the defendants advanced arguments specific to the facts and circumstances of their own case, below are the defendants' general arguments.

- The actuarial assumptions used by the plans are not unreasonable. The mortality tables at issue (e.g., 1971 GAM) are standard mortality tables under IRC regulations for nondiscrimination testing purposes and, therefore, are reasonable. In addition, the defendants argue that the alternative form of benefit and the normal form of benefit are "approximately equal in value" as set forth under IRC regulation C.F.R. § 1.417(a)(3)-1(c)(2)(iii)(C). These regulations governing "relative value" expressly state that a difference of five percent or less in value is deemed to be "approximately equal in value." Furthermore, the interaction between the mortality table and the interest rate allows for the interest rate to offset allegedly outdated mortality assumptions.
- ERISA does not require that actuarial assumptions be "reasonable." ERISA sections 203 and 205, 29 U.S.C. sections 1053 and 1055, do not require that plans use "reasonable" actuarial factors for calculating joint and survivor annuities.
- Congress could have required plans to use "reasonable" actuarial assumptions but it did not. Congress does require the use of reasonable actuarial assumptions, but not for the purpose for which the plaintiffs allege. IRC Section 1085(a) requires that plans use reasonable actuarial assumptions for funding purposes. Also, IRC Section 1393(a)(1)

specifies that, for determining withdrawal liability in the aggregate, reasonable actuarial assumptions must be used. However, no such requirement is found with respect to the calculation of alternative forms of benefit.

- There is no independent private right of action to enforce IRC Regulations. Plaintiffs' claim must be dismissed because there is no independent private right of action to enforce the IRC regulations on which the plaintiffs rely.
- The claims are barred by ERISA's statute of limitations. ERISA states that no fiduciary breach claim may be brought six years after the "the date of the last action which constituted a part of the breach or violation." The plaintiffs received information regarding the actuarial assumptions more than six years from the date of the complaint.
- There is no viable claim for breach of fiduciary duty. There is no breach of fiduciary duty because plan design is a settlor decision, not a fiduciary decision.

Next Steps for Plan Sponsors

While awaiting a more definitive outcome in these cases, plan sponsors should review the interest rates and mortality table specified in their defined benefit plan documents. In addition to providing updates to plan sponsors, Trucker Huss is also available to assist with this analysis.

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An Uncashed Check is Taxable

What happens when a participant in a tax-qualified retirement plan receives a plan distribution but does not cash the check (or cashes the check in a later year)? According to IRS Revenue Ruling 2019-19, the distribution is:

- Includible in the participant's gross income for the year in which the distribution occurs;
- Subject to applicable tax withholding by the plan administrator (or payor) when the distribution is made; and
- Reportable on Form 1099-R for the year of distribution by the plan administrator (or employer).

The ruling states that the guidance equally applies to situations in which the participant chooses to not cash the check, sends the check back to the payor, destroys the check, or cashes the check in a subsequent year.

Generally, when a plan distribution is processed, the plan administrator applies the applicable tax withholding to the gross amount of the distribution and the check is issued for the net amount. Assuming the check is not returned as undeliverable, the plan administrator will report (after the end of the tax year) on a Form 1099-R the distributions made from the plan during the tax year. A participant should include any reported distribution in his or her gross income for that same tax year.

The situation described in the ruling is one in which the plan is required to make a distribution and the participant receives the distribution. Nevertheless, given the practicalities of plan administration, it seems reasonable that the consequences of a participant failing to cash a distribution check (or cashing it in a later year) would also apply to a situation in which the participant requests a distribution. And, it seems reasonable that a plan administrator may assume that a check for a requested (or required) distribution is received by the participant, absent the check being returned as undeliverable, in the year in which the distribution is made.
The IRS states that it will continue to review situations involving uncashed checks and missing participants, so additional guidance is expected on this issue. However, the ruling makes clear that participants may not alter the timing of when a plan distribution is subject to applicable tax withholding and reporting, or when the distribution must be included in their gross income, either by failing to cash a distribution check or by cashing it in a later year.

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5 Ways the New ERISA Employee Benefit Plan Audit Standards Will Affect Your Plans

Changes are coming to auditing standards for employee benefit plans subject to the Employee Retirement Income Security Act of 1974 (ERISA). While most of the updates affect plan auditors, there are implications for your management team. Here are some changes ERISA plan sponsors should expect for their employee benefit audits starting in 2021.

The countdown to revised ERISA employee benefit plan auditing standards officially began this summer when the AICPA's Auditing Standards Board (ASB) released Statement on Auditing Standards No. 136, Forming an Opinion on Employee Benefit Plans Subject to ERISA (EBP SAS). The new standard takes effect for plan years ending on or after Dec. 15, 2020. Generally, it will affect audits of calendar year 2020 plans subject to the Employee Retirement Income Security Act of 1974 (ERISA) that are performed in 2021.

Changes to employee benefit plan (EBP) audit standards come a result of a 2015 study conducted by the Department of Labor (DOL) that found a 39% deficiency rate in EBP audits. The DOL asked the American Institute of Certified Public Accountants (AICPA) to initiate a project to help strengthen the quality of ERISA EBP audits and enhance auditor reporting. The EBP SAS is one of the outcomes of that project. Although most of the EBP audit changes affect auditors, a few of the changes have implications for plan sponsors and their management teams. Plan sponsors, management, committees, and trustees/custodians should review the following to ensure their processes are prepared for the auditing standard changes.

What Your Plan Auditor Will Expect from You

A few of the changes will affect the documentation EBP auditors expect from your organization at the start of your audit.

Management Responsibilities: The new EBP auditing standard makes your management team's responsibilities during an EBP audit even more defined. As a pre-condition of the engagement, your EBP auditor will ask for written documentation acknowledging your organization is the party responsible for plan compliance, including keeping the plan documents current, and that plan contributions and distributions follow the plan's written provisions.

Investment Certification Information: If your organization opts for what is currently called an ERISA limited scope audit—referred to as an ERISA Section 103(a)(3)(C) audit in the new EBP SAS—you will be required to provide certain written representations related to the reliability of the certified investment information.

Currently, auditors may issue a disclaimer of opinion for an ERISA limited scope audit. The EBP SAS clarifies the auditor's role in an ERISA 103(a)(3)(C) audit (formerly an ERISA limited scope audit) by requiring an auditor to issue an opinion on the fair presentation of the amounts and disclosures in the financial statements, other than those derived from certified investment information, and that the information related to assets held and certified by a qualified institution agrees with the information prepared and certified by an institution that management determined meets the requirement of ERISA Section 103(a)(3)(C).

Complete Form 5500: Plan sponsors must be able to produce a completed (or substantially complete draft) Form 5500 in order for their auditor to identify material inconsistencies and material misstatements of fact, if any, with the audited ERISA plan financial statements prior to dating the auditor's report. A draft of the Form 5500 that is substantially complete will include the related forms and schedules.

What to Expect From Your Plan Auditor

EBP auditors will also have new considerations, as the EBP SAS affects nearly every part of the ERISA plan audit. Plan sponsors and management teams will likely notice some of these changes when it comes to how your auditor is required to convey plan deficiencies to the management team in writing.

A Closer Look at Plan Compliance Issues: Areas of plan reporting that tend to have a high rate of compliance issues, such as prohibited transactions, will be getting a closer review from your plan auditor. The new EBP SAS encourages plan auditors to review the plan provisions that carry the greatest risk of material misstatement at the appropriate assertion level. Translation: the higher the risk of material misstatement, the closer the auditor scrutiny.

Risk Assessment Results: EBP auditors will be looking for anything that meets the threshold of reportable findings when they conduct the plan audit. If they find issues that reach the reportable findings level, your EBP auditors will send written notice of these findings to your management team in a "timely manner." Your plan auditor may have additional points to discuss with your management team, such as questions about your investment certification information, if you are

undergoing an ERISA Section 103(a)(3)(C) audit. If there were no reportable findings, do not expect a communication from your auditor to that effect.

Preparing for Your First Audit under the EBP SAS

For your ERISA EBP audits that are subject to the new EBP SAS, plan sponsors will want to be sure they have acknowledged—in writing—that they are:

- Maintaining a current plan instrument
- Administering and determining that plan transactions are presented and disclosed in the plan's financial statements in conformity with plan provisions.
- Maintaining sufficient records for plan participants.

If you elect an ERISA section 103(a)(3)(C) audit (formerly an ERISA limited scope audit), you will also be required to acknowledge in writing that you have determined:

- An ERISA section 103(a)(3)(C) audit is permissible.
- The entity preparing and certifying the investment information is qualified to do so.
- The certified information is appropriately measured, presented and disclosed.

Where to Address Questions

Auditors cannot early adopt the EBP auditing changes, which means you and your plan auditors have some time to evaluate your EBP audit process and any changes needed before the effective date of the EBP SAS. If you have any concerns about employee benefit plan audit standard changes, you should contact a member of our EBP team.

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Improving Your Retirement Plan Governance

It is not hyperbole to suggest that you as a retirement plan sponsor must take seriously your fiduciary responsibility. This includes plan governance, such as a review of the risks that threaten the plan's compliance with ERISA requirements, an analysis of portfolio performance vis-à-vis benchmarks and peers, and a determination of whether plan participants will have the resources necessary to meet their expected retirement income needs.

It is not wholly unexpected for plan sponsors to be challenged by their duties when it comes to plan governance. With all the responsibilities before your company to remain profitable and expand market presence, an administrative task of this nature can be seen as a low priority. This type of mentality can be detrimental for you as a plan sponsor, particularly in the wake of increasing legal liability and plan inefficiencies that raises the cost of your plan and reduces the plan's expected return.

Defining Plan Governance

Plan governance is the framework that assists in effective decision-making over the retirement plan, from plan documents and operations to investments and financial reporting. A proper plan governance procedure provides structure and authority over the processes and policies for managing the retirement plan, along with the roles and responsibilities of the plan administration team.

Benefits of Having a Plan Governance Procedure

Plan governance is an important part of a plan sponsor's fiduciary responsibility under ERISA. Not only is it necessary to ensure compliance, it is good practice for the sponsor and other fiduciaries involved with the plan. It provides peace of mind for participants in addition to identifying deficiencies (or gaps) that can be immediately addressed before they can significantly impact a plan's results.

A strong governance process benefits the sponsor, the participants, and meets many of the items on the fiduciary checklist. It lowers the risk of potential liabilities that come with a breach of fiduciary responsibility, which could lead to penalties and fines being imposed, as well as expensive and lengthy lawsuits. It reduces the risk potential that a plan is disqualified by the DOL or IRS and lowers potential operating expenses. Moreover, a well-structured plan governance procedure is likely to result in:

- fewer administrative headaches,
- improved financial controls,
- and streamlined plan decision-making.

Developing an Effective Plan Governance Procedure

We review what steps to take to develop an effective plan governance procedure.

Identify Fiduciaries & Plan Service Providers

Proper identification and documentation of the plan's fiduciaries is the first step for proper governance. It's important to identify all members, including individuals, committees, and plan service providers. Document each role and their responsibilities. More importantly, any and all members involved in the plan oversight should provide formal acknowledgement of their roles and responsibilities.

Fiduciary training

Once the list of fiduciaries has been established and documented, it is important that training be provided. This training focuses on those specific responsibilities and duties under ERISA that must be observed to maintain compliance. The training, beyond a discussion of basic rules, should also

provide information on how one becomes a fiduciary (which is more a function of activity/action than title). The fiduciary training should stress the risks and liabilities incurred when acting as a fiduciary unintentionally. Trainings should be conducted on a regular basis, or if there are any new members or there are changes in responsibilities.

Document Amendment/Termination Process

If your plan document, committee charter and investment policy statement do not sufficiently assign areas of responsibility, particularly in the areas of investment management and oversight and a determination that fees being charged are reasonable, it may have fallen out of compliance with requirements under ERISA. This will include the filing of certain 5000 series forms with the IRS, notification of benefits, termination and rollover notices to affected participants. Here is where the services of an outside consultant experienced in plan governance review becomes important and vital.

Plan documents should include key provisions, such as eligibility, contribution limits and distributions. Any changes pertaining to the operations of your plan, it is crucial to update the plan document accordingly.

Other Important Considerations

Beyond the main steps that are required to improve your retirement plan governance, there are some additional aspects of plan administration that need to be addressed. These areas are critical in providing a check on investment performance and ensuring that plan participants are kept up-to-date of any and all important (and in many cases required) notifications.

These additional steps include:

- Investment Management and Monitoring – plan governance must address the process required to manage investment performance and assign monitoring tasks to ensure that performance matches expectations. An Investment Policy Statement is not required, but it is highly recommended.
- Compliance Monitoring – plan governance must assign the task of monitoring the operation of the plan in accordance with applicable laws. Relevant to identifying plan fiduciaries, there should be documentation related to who are responsible for coordinating compliance monitoring activities.
- Participant Communication – a communications plan should be incorporated in plan governance. Plan sponsors are required to provide a number of basic disclosures to participants. It should be noted what notifications and disclosures are required and when it needs to be communicated.
- Annual Plan Review and Reporting – a process for reviewing the plan and complete required forms (I.e. Form 5500) must be addressed as part of overall plan governance.

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New U.S. Department of Labor Guidance Helps Employers Manage Pension Obligations for Uniformed Service Members Returning To Work

The U.S. Department of Labor's Veterans Employment and Training Services (VETS) has released a fact sheet to help employers better understand their responsibilities toward reemployed service members under the pension provisions of the Uniform Services Employment and Reemployment Rights Act (USERRA) and related regulations.

USERRA requires that returning service members, on reemployment, be treated as though they did not have a break in civilian employment for the purpose of participation, vesting, and accrual of pension benefits from their employers by reason of their absence due to service in the uniformed services.

The VETS USERRA Fact Sheet #1: Frequently Asked Questions-Employers' Pension Obligations to Reemployed Service Members under USERRA provides quick and direct guidance to employers and employees in a readily understandable format concerning the application of USERRA to employers that pay pension benefits as a percentage of total earnings of employees. It can benefit any employer seeking a greater understanding of its pension obligations under USERRA. It can also help employers reemploy and retain valued service member employees on their return from the performance of uniformed service in support of the national defense.

"Ensuring our service men and women enjoy the appropriate rights and benefits of their civilian employment on their return from duty encourage future service and provides for the security of our nation," said Deputy Assistant Secretary Sam Shellenberger of the Veterans' Employment and Training Service (VETS). "No employer wants to lose a valued employee, and VETS wants to help both employers and employees understand their rights and responsibilities under the Uniform Services Employment and Reemployment Rights Act. This guidance seeks to do just that."

USERRA encourages service in the uniformed services by eliminating or minimizing the disadvantages to civilian careers and employment. The law seeks to minimize the disruption to the lives of persons performing service in the uniformed services as well as to their employers, their fellow employees, and their communities. By providing for the prompt reemployment of our service members, and affording them the appropriate rights and benefits of their employment following their military service, we can achieve those goals.

The Office of Compliance Initiatives (OCI) is a cross-agency effort that complements the Department's enforcement activities by strengthening and innovating compliance assistance outreach to provide employers and workers with access to information about their rights and responsibilities. In furtherance of that aim, OCI launched Worker.gov and Employer.gov, both of which, in addition to the Department's elaws Advisors, address a range of employment issues, including employment protection for uniformed service members.

The mission of VETS is to prepare America's veterans, service members and their spouses, for meaningful careers; provide them with employment resources and expertise; protect their employment rights; and promote their employment opportunities. Learn more about VETS.

The mission of the U.S. Department of Labor is to foster, promote, and develop the welfare of the wage earners, job seekers, and retirees of the United States; improve working conditions; advance opportunities for profitable employment; and assure work-related benefits and rights.

Provided by Bennett Gamble of the Veterans' Employment & Training Service dol.gov