

BCG Retirement News Roundup

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

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

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

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The California Rule on Public Employee Pensions Under Attack: Will We Still Call It The “California Rule” If It Is No Longer The Rule In California?

Most public employees in California are eligible to enroll in a state or county retirement system. These retirement systems are governed by state statutes, known primarily as either the Public Employees’ Retirement Law (“PERL”) or the County Employees’ Retirement Law (“CERL”), depending on the retirement system in question.

While the legislature enacts statutes to provide benefits in retirement, the California courts have developed what is known as the “California Rule” regarding vesting of these benefits. This judicially created rule states that public employees in California have vested rights in their pension benefits, and therefore begin earning this deferred form of compensation from their very first day of employment. While they may not remain employed long enough to actually receive benefits, as long as they do remain employed, they have the right to keep earning this deferred compensation to be paid after they retire. The courts have held that these pension benefits cannot be modified unless: (1) the modification maintains the integrity of the system; (2) bears some relation to the theory of the pension system; and (3) if the modification results in some disadvantage, it is accompanied by a comparable new advantage. Practically speaking, this makes it difficult for the state legislature to revise pension statutes in order to allow reductions in benefits that had previously been promised to public employees. The result is that promises made years or decades earlier generally cannot be modified despite current exploding costs being absorbed by public employers.

On September 12, 2012, Governor Jerry Brown signed into law the Public Employees’ Pension Reform Act of 2013 (“PEPRA”) in order to address the looming crisis of increasing pension costs. PEPRA primarily changed the pension benefits that employees hired after its enactment could expect. However, PEPRA also modified some of the pension benefits for existing public employees under both the PERL and CERL. Some of these changes include the discontinuation of the right to purchase service credit not related in any way to prior employment (known as “airtime”), as well as the discontinuation of certain types of compensation in pension calculations, among others. There are currently several cases before the California Supreme Court, which will analyze whether PEPRA changes to existing employees’ pension benefits violated the California Rule.

On December 5, 2018, the California Supreme Court heard oral argument in *Cal Fire Local 2881 v. CalPERS*, which it chose to hear first. The state intervened in the case to defend PEPPRA. In this case, public employees are challenging PEPPRA's elimination of "airtime." The appellate court held that employees did not have a vested right to purchase airtime because there was no express language in the statute, or its legislative history, that unambiguously stated an intent by the Legislature to create a vested pension benefit. Alternatively, the appellate court held that it was permissible to eliminate "airtime" because a pension system was established to compensate for actual work and that, in fact, the option to purchase "airtime" was detrimental to the successful operation of the pension system because it does not relate to any work performed. Finally, the appellate court held that while a comparable new advantage "should" be provided, the term "shall" in prior decisions was not a mandate. If upheld, this decision would mark a serious erosion of California public employee pension vesting principles.

During oral argument before the California Supreme Court, the justices directed questions at both attorneys to address whether the opportunity to purchase airtime was a vested right. The employees argued that the opportunity to purchase airtime was a vested right upon one's acceptance of and/or continued employment. The justices challenged this notion because any such rule may be overbroad and may apply to any employment benefit offered to an employee. Interestingly, the justices did not question either side on whether there needed to be a comparable new advantage provided to employees in exchange for the elimination of the right to purchase "airtime."

On the other side, the state argued that the legislature never intended for this opportunity be to a vested right, neither expressly nor impliedly. The justices seemed to concede that there was no express language that created a vested right, but questioned whether the legislature could ever create an implied right to a benefit and if so, how. The state responded that there appears to be an implied right to a "substantial, reasonable pension," but that purchasing "airtime" was not necessary to providing a substantial, reasonable pension.

While it is usually difficult to predict a court's final ruling based on the questions the justices ask during oral argument, the court could be signaling its direction here given the questions it did not ask. Specifically, the justices did not ask about the heart of the California Rule; whether alternative benefits must be provided whenever a vested right is impaired. Given the other cases pending before the Supreme Court and the nature of the justices' questions in *Cal Fire*, the court appeared to signal that it will likely issue a narrow ruling related to airtime itself, allowing major components of the California Rule to be argued in later cases. In any event, even if the Supreme Court overturns the

California Rule in full and allows pension benefits to be modified more easily, there is unlikely to be an immediate impact on California public employees nor relief to public employers facing ever-increasing pension costs. Any change to public employee pension benefits must first come from the state legislature. While overturning the California Rule would, in theory, make it easier to modify pension benefits, it would still be up to the state legislature, not individual public employers enrolled in these pension plans, to first make modifications to the state statutes. Absent such statutory change, these benefits will remain largely untouchable, regardless of the court's ultimate decision.

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Average funding ratio for public pension plans increases in 2018 — NCPERS survey

The average funding ratio for public pension plans rose in 2018 from the year before, while the average one-year investment returns jumped significantly on a year-over-year basis, said results of an annual survey by the National Conference on Public Employee Retirement Systems.

Results of the 2018 NCPERS Public Retirement Systems Study showed that the average funding ratio for all plans that responded rose to 72.6% in 2018, from 71.4% in 2017. For pension plans that participated both years, the average funding ratio jumped to 72.2%.

"The nation's public pension systems are constantly adapting plan designs and assumptions to strengthen their ability to provide a secure retirement for millions of retired public servants," said Hank H. Kim, executive director and chief counsel, in a news release announcing the survey results.

Meanwhile, one-year investment returns averaged 13.4% for all pension plans reporting in 2018, well above the 7.8% average return reported in 2017.

The survey also showed that the average annual investment return assumption dropped to 7.34% in 2018, from 7.49% in 2017. Nearly two-thirds of survey respondents — 65% — had reduced their assumptions, with 18% saying they were considering doing so.

"Pension fund results improved in 2018 even as they became more conservative in their assumptions," Mr. Kim added.

The survey received responses from 167 state and local government pension funds totaling more than \$2.5 trillion in assets. Of the respondents, 62% were local pension

funds, while 38% were state plans. NCPERS conducted the eighth annual study from September through December in partnership with Cobalt Community Research.

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Kentucky universities ask to be let out of pension plan as costs become unsustainable

Regional universities in Kentucky are asking lawmakers to move their new employees into a new plan, more like a 401k, to ensure pension costs don't continue to hinder their budgets.

The House State and Local Government Committee Thursday passed House Bill 358, which would place all new hires into a university-sponsored defined contribution system rather than the pension plan, freezes contribution rates for the next year so costs don't continue to rise, and gives universities a way out of the system and mechanism to pay off their unfunded liabilities within the system over a set number of years.

The legislation comes as a result of work by the presidents of the regional universities as increasing pension costs are becoming a huge budget issue.

Northern Kentucky University President Ashish Vaidya stated the university will be unable to achieve goals for students and the region under the current system.

Rep. James Allen Tipton, R-Taylorsville, the sponsor of the House Bill 358, said the legislation gives the universities an opportunity to make decisions about what is the best option for them moving forward after seeing their liability in the system and deciding whether or not to get out of the pension system completely.

Under the bill, the regional universities would see:

- All new hires into the system moved into a university-sponsored defined contribution plan.
- A one-time window for existing Kentucky Retirement System (KRS) employees to opt-out of their current plan and go into the more portable university-sponsored plan.
- A study showing the unfunded liabilities for each regional university based on active, inactive, and retired employees.
- An option to get out of the system completely and a set number of years to pay off

their unfunded liabilities with a 5.25 percent interest rate.

- A freeze to the current 49 percent contribution rate over the next year and extend it while the actuarial analysis is being conducted so they don't see their rates rise to 84 percent that other employers in the system are currently paying.

While there was not an actuarial analysis presented with the bill, some lawmakers argued it would be difficult to know the full fiscal impact to the system before seeing how many employees choose to opt out of the system. However, it was stated KRS would be working on such an analysis.

House Bill 358 passed through the committee with 12 members voting in favor, two against, and four members passing on the vote.

In voting for the bill, Rep. Jason Nemes, D-Louisville, stated he feels middle- and lower-class families have been priced out of attending college and believes this bill is an important step forward so the state can make higher education more affordable by lessening their burden so those costs aren't passed onto students.

The bill now moves to the full House for a vote on the floor.

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A first-ever public pension funded by cryptocurrency

State employees in Fairfax County, Virginia may be looking ahead to retirement with a pension funded by a less conventional investment class – cryptocurrency.

In what is understood to be a first, two pension funds that support state employees have invested in a digital assets based venture capital fund, Bloomberg reported on Tuesday. Fairfax County Police and Fairfax County Employees' pension plans – which combined, are responsible for managing \$1.2 billion in assets – are the two pension funds that have invested in Morgan Creek Blockchain Opportunities Fund.

Whilst the two pension funds are the anchor investors in the venture capital fund, investment has also been secured from an insurance company, a university endowment and a private foundation.

For the most part, institutional investment has eluded the cryptocurrency sector. At an institutional level, fund managers are conservative and not comfortable with investing in the nascent sector due to fears of market manipulation.

According to CoinMarketCap, the cryptocurrency market has a total market capitalization of \$120 billion at the time of writing. In the context of investment classes generally, this is just a

drop in the ocean. Gold has a market capitalization of approximately \$100 trillion whilst the S&P500 has a market capitalization in the region of \$22 trillion. It's for this reason that cryptocurrencies are particularly susceptible to market manipulation.

Fund managers also have concerns with regard to regulatory compliance when it comes to cryptocurrency. Some clarity was achieved in 2018 with regard to regulation but regulatory frameworks are still incomplete. There are also security concerns with regard to the storage of digital assets amidst a backdrop of multiple cryptocurrency exchange hacks in recent times. Given the cryptocurrency bear market which has been ongoing since January 2018, many in the sector have been awaiting an influx of institutional money to bring the market back into the green. In particular, many have been awaiting the approval of a Bitcoin exchange traded fund (ETF).

However, co-founder of Morgan Creek Digital, Anthony Pompliano took to Twitter to claim that through investment in his company's digital asset based venture fund, institutional investment is already in play:



Pomp

✓ @APompliano

This morning our team at Morgan Creek Digital announced a new \$40 million crypto venture fund anchored by two public pensions.

The institutions aren't coming.



They're already here.

4,642

6:50 AM - Feb 12, 2019

[Twitter Ads info and privacy](#)

Pompliano founded Morgan Creek alongside Mark Yusko and Jason Williams, providing access to blockchain technology and digital assets to institutional clients as a global asset manager. A well-known figure in the industry, 'The Pomp' as he's known in the industry, is influential in the space not just through his involvement with Morgan Creek Digital but also via his well regarded podcast, "Off The Chain".

It's clear that Pompliano has been working on securing pension fund investment for some time. Last Christmas Eve, he published a blog post titled "Every pension fund should buy Bitcoin", setting out his rationale for pension funds to incorporate digital assets in their investment mix. Pompliano referred to the pensions crisis whereby many pension funds are unable to pay their future obligations. He makes the case for investment in Bitcoin on the basis that it's a non-correlated asset and in this way, it minimizes risk as it doesn't correlate with the S&P500.

Furthermore, he articulates that it has an asymmetric risk profile, with much more potential upside than downside in owning the asset.

Chief Investment Officer with Fairfax County Police Officer's Retirement System, Katherine Molnar commented in Forbes on the investment:

"Blockchain technology is being applied in unique and compelling ways across multiple industries. We feel it is important to be opportunistic and are excited to participate in this emerging opportunity, due to the attractive asymmetric return profile that it represents."

A small proportion of the fund will be invested in cryptocurrencies such as Bitcoin. Otherwise, Morgan Creek Digital will use the capital as seed funding for various crypto and blockchain related startups. The company has previously invested in Coinbase, Harbor and Bakkt. Last month, it participated in a funding round for tokenized real estate startup, RealBlocks, according to The Bitcoin Mag.

Public plans surf wave of reforms in aftermath of crisis

Great Recession spurs states to tackle problems

One of the many dramatic effects of the Great Recession was an unprecedented amount of public pension reform activity that is just now starting to ebb.

After state and local pension fund assets plummeted to \$2.17 trillion in March 2009 from \$3.15 trillion at the end of 2007 and the governments' own coffers took a hit, policymakers began looking hard at ways to manage rising pension costs, according to a December report from the National Association of State Retirement Administrators. The report found nearly every state passing "meaningful" reform for one or more of its pension plans.

"States have always made reforms, but what was untypical was the magnitude," said Alex Brown, the Washington-based research manager for NASRA.

The number of states enacting pension reforms skyrocketed to 27 in 2011, up from five in 2007, NASRA found. In 2016, reforms were enacted by three states, then spiked again to 13 in 2017, falling once again to just five last year.

So far in 2019, just a few states are actively discussing reforms.

In Kentucky, a legislative working group is reviewing the pension systems for possible changes after the Kentucky Supreme Court in December struck down on procedural grounds a pension reform bill signed into law in April. The law enrolled new teachers into a cash balance plan and reset the 30-year amortization period to pay off the unfunded liabilities of the \$17.4 billion Kentucky Retirement System, Frankfort, among other changes.

Georgia legislators will soon have pension reform proposals to consider, following an audit showing potential cost savings from plan design changes for teachers' pensions and cost-cutting measures at the \$16 billion Employees' Retirement System of Georgia, Atlanta.

In New Mexico, legislators will be working on a pension solvency plan with input from the board of the \$15.5 billion New Mexico Public Employees Retirement Association, Santa Fe, which in December recommended increasing contributions from employees and employers, plus temporarily suspending and later reducing cost-of-living increases.

Stress-testing

Another recent concept is mandated stress-testing of public pension funds to help policymakers prepare for the next economic downturn. While public plan actuaries have always done stress-testing or similar modeling, Greg Mennis, director of public sector retirement systems for Pew Charitable Trusts in Washington, is seeing the idea of formal, annual stress-testing gain traction. California and Washington state were joined in recent years by Connecticut, Colorado, Hawaii, New Jersey and Virginia, where legislation dictates it.

A study of reform activity through 2014 by the Center for Retirement Research at Boston College found that since the financial crisis, 74% of state plans and 57% of large local plans have cut benefits or raised employee contributions to curb rising costs. Plans most likely to enact changes were those with a larger cost burden and lower initial employee contributions.

States with the strongest legal protections for worker benefits were more likely to limit the cuts to new hires. "That's been the main lever that plans can use, although it is important to note that it is not going to have an impact on current funding," said Caroline Crawford, the center's assistant director of state and local research.

Still, nearly one-quarter of plans have made changes impacting current employees. The most common change has been cutting cost-of-living increases, some of which were overturned in state courts.

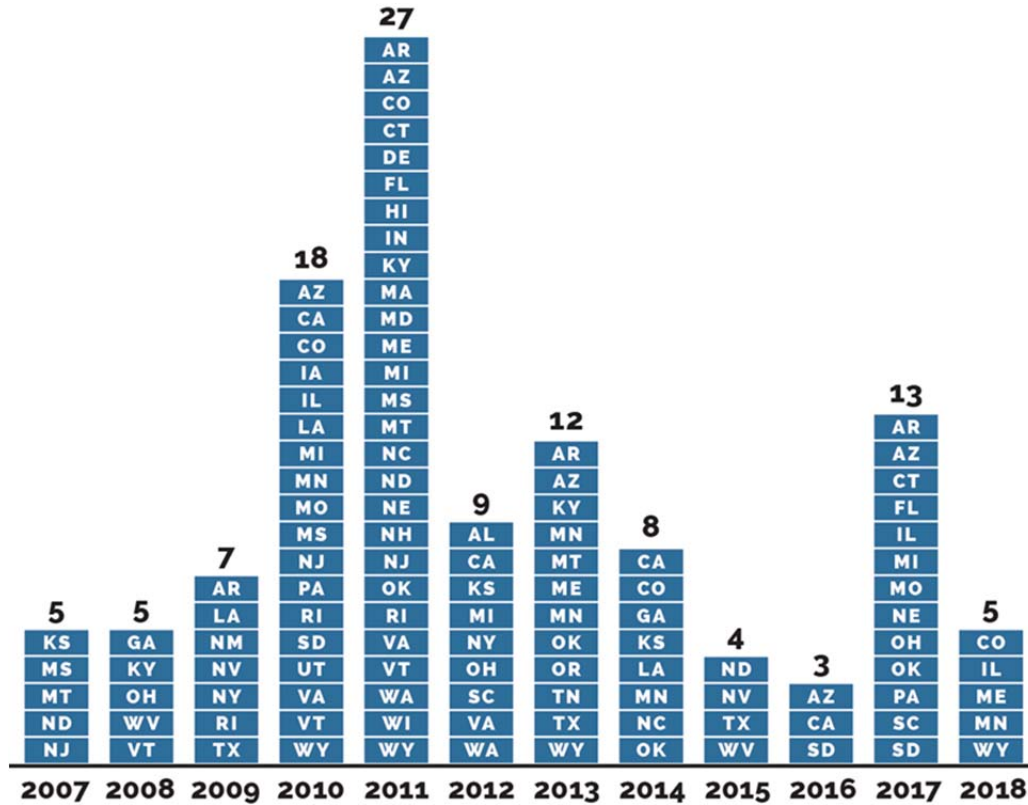
Legal challenges were a common reaction to half of the states enacting reforms, according to NASRA, which found that, "in many cases, what was upheld in one state was struck down in another." Increased employee contributions upheld in Florida were found illegal in Arizona, for example. Colorado's reduced cost-of-living formula was found constitutional, while Oregon's was not.

Constitutional challenges to pension changes typically cite clauses on contracts or takings. The first clause prevents a state from impairing contractual obligations, and the second prohibits takings of property without legal due process.

Other common reforms increased age and service requirements, with 33 states increasing the retirement age, years of service requirement or a combination of both, according to NASRA.

The pace of state pension reforms

Number and location of reforms to state pension plans by year.



Source: National Association of State Retirement Administrators

Hybrid plans

Eight states — Arizona, Connecticut, Michigan, Pennsylvania, Rhode Island, Tennessee, Utah and Virginia — have created hybrid plans since 2009 for new or existing employees. Kansas and Kentucky created cash balance plans for new hires.

Another trend that appears here to stay is more risk sharing with employees. NASRA found that 23 states have added one or more risk-sharing feature since 2009, ranging from hybrid plans to variable contribution rates and benefits that are subject to change if investment performance or funding levels dip. "In recent years we've seen plans take on additional risk sharing, and in some cases, they are adjusted without being subject to the legislative process," said Mr. Brown.

While increasing employee contributions or trimming benefits is not a new concept, "now it is disclosed upfront," he said. Employees "have effectively learned that they were bearing some of the risk."

Nine states increased the vesting period for new employees to 10 years from five, although two — Missouri and North Carolina — later reversed that after the savings did not materialize and workforce conflicts arose.

The workforce issues related to pension reforms are now coming into focus. A Center for Retirement Research study of how pension reforms from 2005 to 2014 affected state and local government competitiveness in the labor market found that implementing the reforms hampered governments' ability to attract new employees.

Retention is also "a very significant piece" of the conversation, said Diane Oakley, executive director of the National Institute on Retirement Security in Washington. A NIRS study of pension reforms from 2008 to 2013 concluded that adjusting defined benefit plans is more cost efficient than shifting to defined contribution accounts for new hires that would either increase costs to keep benefit levels or lead to bigger benefit reductions.

As state and local governments now experience more retiring employees in an overall tight labor market, that is something to watch, said Joshua Franzel, president and CEO of the Center for State and Local Government Excellence in Washington, an organization that helps state and local governments attract and retain public servants.

"The pension reforms that have been implemented in the wake of the Great Recession ... certainly have impacted their ability to recruit vs. the private sector," he said.

For those and other reasons, said Mr. Franzel, "I see us entering into a period of reduced benefit reforms, and letting a lot of the reforms play out. A lot of plan sponsors will see how their effects will play out from a financial and workforce management perspective."

'New normal'

Another "new normal" that CSLGE found in a 2018 snapshot of 180 public plans' investment data is that a decline in funding ratios since the recession appears to be leveling off, in part because many plans are doing more to improve them, maintaining their annual contributions or even increasing them. Many states are also being more conservative about their investment or mortality assumptions, noted Gerald Young, senior research associate at the center. "There's no reason to think that funding levels will dip lower. Things are leveling out."

According to CSLGE's 2018 snapshot, state and local pension average funding ratios that were 102.1% in 2001 starting falling until 2007, when they saw a slight increase to 86.5%. In 2008, they started dipping again, with modest increases in 2014 and 2015 before leveling off in the last two years, reaching 71.6% in 2017. The snapshot is based on comprehensive annual

financial reports and assessed values as of June 2018.

Bridget Early, executive director of the National Public Pension Coalition, Washington, agrees that things are stabilizing. "What we are looking at are state governments that are in a better place than they were pre- and post-recession, where (the pension) line items on budgets aren't as terrifying as they have been for a long time."

Still, she said, "pension funding is a 30-year equation, and budgeting is a year-by-year item." Her advice for policymakers considering further reforms is to learn from states like Minnesota, where 2018 reforms that cut assumed rates of return, lowered cost-of-living adjustments and increased employee contributions won bipartisan support after all stakeholders were brought to the table.

"It was a very inclusive process," Ms. Early said.

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Private Sector

2018 Pension Plan Report Card – C+ Year

Last year was a so-so year at best for most plan sponsors. For most of the year things looked good but by the end of 2018 there were few things to celebrate. The good news was that interest rates were up year-over-year, but, in December, rates gave up some of the year's increases and the claw back continued into the first few weeks of 2019. Volatile equity markets made for an overall bumpy ride, and again December proved to be a disaster. More than likely plan sponsor will see some funded status deterioration in 2018 largely driven by the December markets. The good news though is that equity markets have already started to rebound in 2019 (for now at least).

This article looks at and grades the various drivers of pension plan funded status that occurred in 2018. When plan sponsors pull these factors together they will find opportunities in 2019 to manage volatility, and execute pension risk transfers to lower plan risk and cost. Finally, with the looming sunset of funding relief sponsors will want to have an eye towards future cash calls.

Market / Investment Performance: D

Risk assets (e.g. equities) started the year strongly. However, volatility ensued quickly with concerns over monetary policy, inflation fears, geopolitical concerns, and signs of economic slowdown across the globe. Ultimately, most global markets ended the year in negative territory and December ended up being the worst month for U.S. stocks since the Great Financial Crisis.

The year ended with the S&P 500 down 4.4%. Developed international equities (MSCI EAFE Index) were down almost 14% and emerging market equities were down about 15%. An appreciating dollar weighed on international markets and particularly emerging markets.

Bond portfolios had poor returns this year as rising rates reduced values. U.S. Treasury interest rates increased. The interest rate curve flattened during the year; short term rates increased more than the long end of the curve as the Fed increased the federal funds rate four times. Consequently, the 3 month rate increased by over 1%, while the longest part of the curve (the 30 year treasury rate) increased by only 0.3%. Volatility also increased in the bond markets and credit spreads widened. This led to higher quality fixed income outperforming lower quality bonds. Intermediate duration bonds ended 2018 flat. High yield and emerging market debt decreased -2.1% and -2.5%, respectively. Long duration corporate

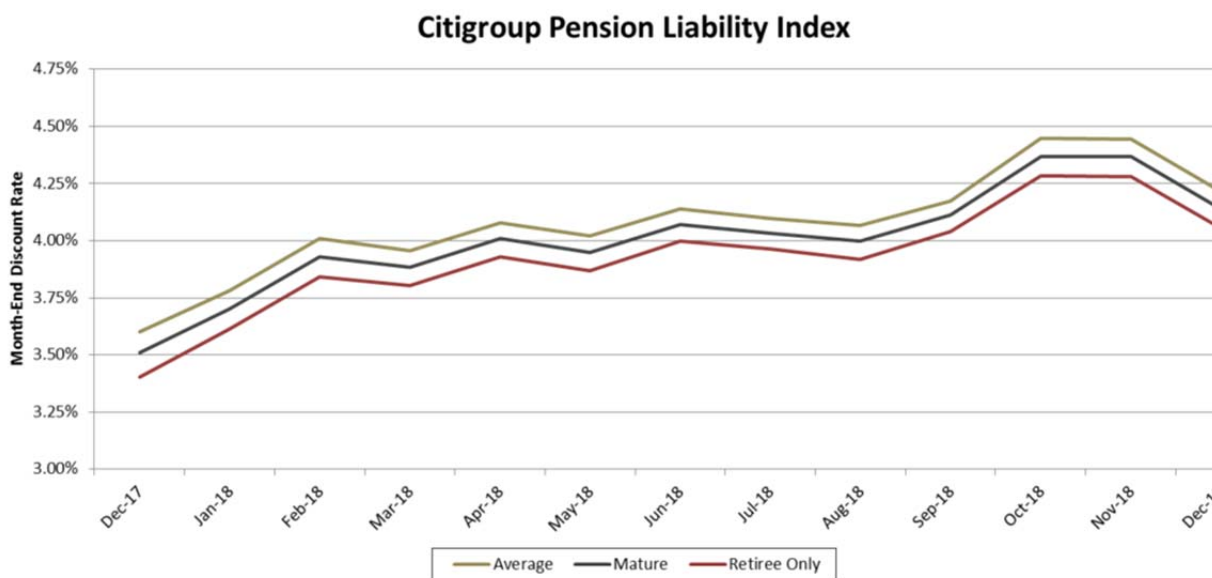
bonds decreased approximately 7% and long duration U.S. Treasuries decreased almost 6%.

Plan sponsors with the traditional 60% equity/40% aggregate fixed income portfolios generally saw their portfolios return down about 5%, while those with 60% equity/ 40% liability matching bonds would have seen their portfolios return down even further around 8%.

Interest Rates (Accounting): B+ (higher than last year)

From the start of 2018, high-quality corporate bond rates that are used for valuing liabilities for accounting purposes were on the climb. This climb continued throughout the year reaching peak levels in October and November. At that point in time discount rates had effectively increased close to 0.85% year-to-date. These rates were just slightly below the 5-year high for discount rates that we saw in the early months of 2014.

Unfortunately, with the market turmoil in December, rates made a sharp decline pulling back around 0.20% by year-end. Even with the decline in December, on the whole 2018 was a great year for plan sponsors with discount rates generally up around 0.65%. While a 0.65% rise in rates might normally earn a low A, December’s pull back makes us a tough grader.



Interest Rates (Funding): C (once again they’ve come down)

The underlying yield curve used in determining minimum funding interest rates made a parallel shift down from the yield curve as of the end of 2017.

Because of the 10% corridor around the 25-year historical average interest rates continues to be in effect, the actual segment rates for calculating minimum funding liabilities are still above the yield curve levels. That said, as in prior years, the 24-month average segment rates with the corridor constraint are down from the beginning of 2018. In general this decline in the segment rates will produce an effective rate that is about 0.20% lower for 2019 and leave sponsors with higher minimum funding liabilities all else equal.

Mortality Assumptions: B (lower liabilities again)

Similar to the last four years, the Society of Actuaries (SOA) published an updated mortality improvement projection scale in the fall of 2018. The update comes as a result of updated data included in their model along with model methodology tweak meant to produce more stable results over time.

What this update means is that sponsors can expect lower accounting liabilities on the order of 0.2% – 0.6% depending on the demographics of their participants.

Legislative – B (status quo once again)

While there have been several proposals floating around Congress that would affect pension plans, there was once again no major legislation passed during the year. The legislation that has been discussed would have fairly insignificant implications for corporate pension plan sponsors with maybe the most impactful being a raise in the mandatory cashout threshold.

Pension Risk Transfers: A (another record year for insurers)

Once again, the annuity buy-out market continued its exponential growth with 2018 premiums expected to be around \$27B. This is up from the record year in 2017 with \$23B in premium sales. One of the more significant transactions of the year was the \$6B FedEx deal that landed in Q2. Through this transaction FedEx transferred the benefit obligations of approximately 41,000 retirees and beneficiaries to MetLife.

2019 has already started off with a bang with Lockheed Martin announcing two transactions totaling \$2.6B (\$1.6B buy-out and a \$800M buy-in), and Weyerhaeuser offloading \$1.5B. The annuity purchase market will continue to provide opportunity to plan sponsors looking to shrink the size of their pension plan and subsequently reduce administrative costs and potential funded status volatility. Pricing is still very attractive with most retiree only deals

coming in around the accounting liability for sponsors that use realistic assumptions for mortality and discount rates. (Check out our Pension Plan Annuity Purchase Update for the latest insights on the pension annuity transfer market.)

Thoughts Going Into 2019:

- **Funded status volatility control** – With many plan sponsors grappling between the trade-off of interest rate hedging and equity return, managing funded status volatility in today’s market environment will prove challenging. As we discussed during 2018, there are strategies that plan sponsors should consider to limit their overall funded status volatility through the use of equity derivatives and liability matching assets. These strategies, when designed appropriately, can help sponsors manage interest rate risk along with equity risk for more predictable funded status outcomes (see Pension Investing – Next Generation of Glide Paths).
- **Shrink-the-ball opportunities (AKA Pension Risk Transfers)** – 2019 is currently a good year to consider a lump sum cashout window for vested terminated participants. For most plans, the rates that apply for calculating lump sums will be based on rates as of last fall when they were at close to 5-year highs. With rates pulling back so far in 2019, the difference in lump sum payouts and balance sheet liabilities should prove favorable to plan sponsors.
- **Keep your eye on future cash calls** – We only have a couple of years left on the interest rate funding relief for minimum funding purposes. As that corridor starts to expand in 2021, sponsors could see dramatic increases in required contributions starting in 2022 (due to contribution timing rules). It is extremely important that plan sponsors understand how much their contributions could increase and adequately prepare for those increases in their future

- **Conclusion**

The poor investment returns suffered by most plan sponsors in 2018 more than offset the reduction in liabilities due the rise in corporate rates. But higher rates have created opportunities for sponsors who want to continue to lower the risk and cost of their plans in 2019.

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It's Audit Time--Do You Know What Your Recordkeeper is Doing?

Is your recordkeeper the plan administrator? All too many 401(k) and pension plan sponsors and committee members still mistakenly believe that their recordkeeper is responsible for all plan compliance. They take a “hands off” approach and simply sign or distribute documents that come from the recordkeeper without review.

I may get a call after they get an audit notice from the IRS or DOL, or after their CPA doing the annual ERISA plan audit identifies a problem, but that is too late to save them time, money, and frustration. I then have to give them the bad news that their services agreement makes them responsible for plan administration even though they are not actually taking care of most compliance matters themselves. This means that they are also responsible for any correction costs and penalties.

Many vendors contribute to this misconception by never explaining all of those exculpatory provisions in their services agreements, but plan sponsors and committee members should be more alert to this issue as well. How many even know what their agreement provides about the responsibilities of the parties?

Every plan fiduciary should be familiar with what the plan’s recordkeeper is doing, and every recordkeeper needs to be familiar with the provisions of the plan, which must be followed at all times. Disconnects between practices and the plan document can even result in the plan’s loss of tax qualification, though that doesn’t happen often. More typically, an expensive settlement with the IRS may be required to keep the plan’s tax benefits.

Some new practices can help insure that the plan is run correctly and avoid potentially expensive penalties. Here are some steps to include in an action plan for coordinating with your recordkeeper—

- Develop a procedures manual with your recordkeeper and in consultation with your ERISA counsel to make sure that plan terms are being followed. For example, one of the most common problems IRS auditors see is a failure to use the correct definition of compensation in calculating plan contributions and benefits. The manual should clearly specify which items of compensation are and are not being counted under the plan. You will also want to cover issues such as withdrawal and loan procedures and how vesting service is calculated in the manual. This is particularly important if you have an individually-designed plan, but pre-

approved (prototype and volume submitter) plans need manuals, too.

- Alternatively, or in addition, develop a controls policy for promptly identifying and correcting mistakes.
- Review a printout at year end to check that annual IRS dollar limits have not been exceeded. Be particularly careful if employees have transferred from one related company to another to make sure that all of their compensation and contributions have been counted.
- Ask the recordkeeper to notify you right away if checks or notices are returned as undeliverable, so that you can make an effort to find these missing participants, which is a fiduciary obligation. Notify the recordkeeper right away when participants terminate employment.
- Do regular self-audits so that you can identify and correct problems before the auditors find them. This will enable you to use voluntary corrections procedures to correct any identified problems. Make sure that a party unrelated to the recordkeeper is doing the self audit, as the whole point is to have a fresh eye evaluating what has been done.
- Make sure the recordkeeper gets correct data for non-discrimination testing. Ask questions if you don't understand what information is being requested because mistakes can lead to false pass results requiring expensive corrections.
- Review your draft Form 5500 carefully to make sure the answers are correct. Answers on this form can lead to IRS or DOL audits. Make sure that any mistakes you identify are corrected and that the form is filed on time.
- Review your recordkeeper's cybersecurity procedures and insurance to make sure that participant data is properly protected. You may be responsible for benefits paid out due to fraud.

Implementing these recommendations will take time, but it will be time well spent. Your ERISA counsel can be a valuable resource in this process.

Lawmakers ask GAO to explore cybersecurity issues in defined contribution plans

The increase in retirement savings held in defined contribution plans, the ubiquity of online accounts and the large number of digital interactions between plans and service providers present "a tempting target" for criminals, two legislators wrote in a letter Tuesday to the Government Accountability Office.

Sen. Patty Murray, D-Wash., and Rep. Robert C. "Bobby" Scott, D-Va., sent the letter to Gene Dodaro, comptroller general of the GAO, requesting the office to examine cybersecurity in the private retirement system. Ms. Murray, is the ranking member on the Senate Health, Education, Labor and Pensions Committee and Mr. Scott is chairman of the House Committee on Education & Labor.

The "cybersecurity safeguards, risks and liabilities for plan sponsors and participants remain ill-defined, especially with regard to major data breaches or advanced persistent threats," the letter stated.

Current law, the letter continued, does not "address a number of questions related to cybersecurity, and plans fall within a patchwork of federal and state laws and regulations."

Among other questions, the legislators asked the GAO to address what plan sponsors and service providers are doing to protect plan data. Also, in the event of a data breach, what steps should sponsors be required to take to protect plan participants? The lawmakers also asked what the possible legislative or regulatory options are to protect data and account information.

With the patchwork of regulations in mind, the SPARK Institute, which formed the Data Security Oversight Board composed of industry stakeholders, published a set of cybersecurity best practice standards in 2017. The standards are intended to help establish guidelines to assist plan sponsors and service providers in properly assessing and comparing retirement plan vendors, he said. Plan sponsors, through their consultants, are using the standards to evaluate record keepers' data-protection capacities without record keepers having to disclose their methods.

Washington Pulse: Familiar Retirement Reforms Already in Play in New Congress

The new 116th Congress begins with a blank slate as bills introduced in the 115th Congress have sunset with the transition. But lawmakers and Hill watchers may justifiably have a sense of déjà vu, as familiar retirement legislation has been introduced in the brief period since the new Congress convened in January. Despite the U.S. House of Representatives flipping to Democratic control in November's midterm elections, retirement reform remains an issue where significant bipartisan support is evident, and clearly growing.

The Retirement Enhancement and Savings Act of 2019 (RESA 2019) is the latest version of a bill that has been introduced in Congress multiple times since 2016. But, despite bipartisan support the legislation has failed to advance.

RESA 2019, whose primary sponsors are Rep. Ron Kind (D-WI) and Mike Kelly (R-PA), would make many changes to the retirement saving landscape that are primarily intended to achieve three objectives: encourage more employers to offer retirement plans, and encourage greater accumulation and preservation of savings in retirement plans and IRAs

Several significant items included in the bill and intended to address the bill's objectives are described below.

Allow Pooled Employer Plans to Encourage Offering Workplace Saving Options

More than one-third of Americans have no access to an employer-sponsored retirement plan. Often-cited obstacles for employers considering establishing a plan —especially among small to mid-size employers—are the cost, administrative responsibility, and potential fiduciary liability. One proposed remedy in RESA 2019 is enhancement of the multiple employer plan (MEP) option. MEP arrangements allow many employers to participate in a commonly-administered plan, with the flexibility to tailor provisions to their respective needs. Proponents hope this will yield economies of scale that lead to reduced cost, greater sharing of administrative burden and reduced fiduciary liability for participating employers

Past regulatory restrictions have required MEP-participating employers to have a commonality among them (e.g., common ownership, business purpose, etc.). This has greatly limited use of the MEP concept. Among other MEP enhancements, RESA would permit “open MEPs” by creating “pooled employer plans” (PEPs). PEPs would be exempt from the commonality requirement and would be required to specify a “pooled plan provider” that is the plan's named fiduciary and plan administrator. The result could be more employers offering a

retirement plan to their employees.

Lifetime Income Investments – a Solution to Outliving Retirement Savings?

In addition to the issue of workers having no workplace retirement plan, there is great concern that the savings of many will not be enough to support them through their retirement years. An often-proposed solution is greater use of so-called “lifetime income investments,” which can be used to transform accumulated savings into an income stream throughout retirees lives. Such investments, whose payout in retirement can resemble a payment stream from a defined benefit pension plan, have seen limited use in the past. A major obstacle to their use has been the concern of retirement plan sponsors over potential fiduciary liability for the soundness of the lifetime income provider.

RESA 2019’s sponsors hope to address employers’ fear of fiduciary liability. The bill would require an annual statement that projects potential lifetime income payments—using a participant’s actual accumulation—in the hope of stimulating increased saving and increased use of lifetime income products to provide a secure retirement. The legislation also offers a new fiduciary safe harbor to encourage more employers to offer these investments in their plans.

Will Tax Incentives Motivate Employers and Savers?

RESA 2019 contains several tax incentives for establishing retirement plans and for workers to save more. The maximum tax credit for small employers establishing a plan would be 10 times greater. A new credit for implementing automatic enrollment of employees would be created. All workers—or those whose spouse has earned income—would be eligible to make Traditional IRA contributions beyond age 70½.

Proposal to Eliminate Life Expectancy Payments to Nonspouse Beneficiaries Remains

While RESA’s provisions generally have been welcomed, one that is particularly complex would require most nonspouse beneficiaries of IRA and employer plan accounts to distribute them and pay any taxes owed within five years, for aggregate balances that exceed \$450,000. Lesser amounts could be distributed and taxed over a beneficiary’s lifetime. This provision is included in RESA 2019—as it has been in other legislation—to raise tax revenue in order to offset various incentives and enhancements the bill contains.

DOL Hot on the Trail of Missing ERISA Plan Participants

Missing people, missing money. It's hard to believe people would leave retirement funds behind when they move to a new job. But it happens. In fact, many people fail to roll over retirement plans when they move to a new employer. Plan administrators and sponsors then are faced with a dilemma – and sometimes unclear or evolving guidance from government agencies that oversee employee retirement plans. Currently, the Department of Labor (DOL) is taking steps to address missing ERISA plan participants.

It started with one DOL office

Audits are nothing new. The DOL has the power to audit any retirement plan to ensure compliance with government regulations. However, the Philadelphia DOL office began targeting defined benefit plans with a high number of terminated vested participants who:

- were not receiving payments, and
- had not received payouts.

In some cases, plan sponsors informed the DOL that plan participants were simply missing. However, when contacted by the Philadelphia DOL, it became apparent that many participants simply had not known they had money sitting in their former retirement plans.

By following up, the Philadelphia DOL was able to recover more than \$165 million for these missing ERISA plan participants.

Going forward, the DOL intends to treat failure to locate missing plan participants as a breach of fiduciary duty under ERISA. Non-compliant plans may face significant penalties. This is somewhat of a reversal of a former DOL attitude that plans simply wait for participants to locate them.

The Internal Revenue Service has a role also

Plan administrators and sponsors may run afoul of Internal Revenue Service guidelines contained in its October 19, 2017, Memorandum for Employee Plans Examinations Employees. In this memorandum, examiners are advised not to challenge qualified plans for required minimum distribution (RMD) failures under certain circumstances if the plan:

- “searched plan and related plan, sponsor, and publicly-available records or directories

- for alternative contact information;
- Used any of the search methods below:
 - a commercial locator service;
 - a credit reporting agency; or
 - a proprietary internet search tool for location individuals; and
- attempted contact via United States Postal Service (USPS) certified mail to the last known mailing address and through appropriate means for any address or contact information (including email addresses and telephone numbers).

Does your company have missing ERISA plan participants?

Expect an increase on audits specifically targeting employers with missing retirement plan participants. Plan sponsors should work with ERISA counsel to establish a paradigm for locating and contacting terminated vested plan participants.

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