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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CalPERS Reports Preliminary 6.7 Percent Investment Return for Fiscal Year 2018-19

CalPERS today reported a preliminary 6.7 percent net return on investments for the 12-month period that ended June 30, 2019. CalPERS assets at the end of the fiscal year stood at more than $370 billion.

Drivers of the return included the Fixed Income program, which generated a 9.6 percent net return, followed by Private Equity and Public Equity net returns of 7.7 percent and 6.1 percent returns respectively.

Based on these preliminary fiscal year returns, the funded status of the overall CalPERS fund is an estimated 70 percent, down less than a percentage point from fiscal year 2017-18. This estimate is based on a 7 percent discount rate.

"This was a very volatile year for financial markets, but I'm pleased with how we focused on the performance of the total fund," said Yu (Ben) Meng, CalPERS chief investment officer.

"We saw good returns in several key areas. Our long duration fixed income portfolio contributed positively as interest rates fell. And we are pleased with the outcome of some allocation changes made during the year, which we estimate contributed 70 basis points to fund performance.

"While we did not achieve our 7 percent actuarial return target this fiscal year, I can't stress strongly enough that we are long-term investors. We make decisions based on an investment horizon that stretches across years and even decades. That's our focus, and we will continue to analyze all aspects of our portfolio to see how we can generate higher risk-adjusted total returns for our members."

This year's return brings total fund performance to 5.8 percent for the five-year time period, 9.1 percent for the 10-year time period, and 5.8 percent for the 20-year time period. Over the past 30 years, the CalPERS fund has returned an average of 8.1 percent annually.

Today's announcement includes asset class performance as follows:

	Net Rate of Return
Total Fund	6.7%
Public Equity	6.1%
Private Equity	7.7%
Fixed Income	9.6%
Real Assets	3.7%
Liquidity	2.6%

Returns for real estate and private equity reflect market values through March 31, 2019.

CalPERS' 2018-19 final fiscal year investment performance will be calculated based on audited figures and will be reflected in contribution levels for the State of California and school districts in Fiscal Year 2020-21, and for contracting cities, counties, and special districts in Fiscal Year 2021-22.

The ending value of the CalPERS fund is based on several factors and not investment performance alone. Contributions made to CalPERS from employers and employees, monthly payments made to retirees, and the performance of its investments, among other factors, all influence the ending total value of the Fund.

Why Public Pensions Are Taking More Risk Assumptions

Public pension funds, particularly those with higher underfunded statuses, are taking on more risk as rates stay low.

In a low-interest-rate environment, public pension funds facing widening gaps between their assets and liabilities are making riskier investments, new research shows.
The United States Federal Reserve has kept interest rates low in the wake of the Great Recession of 2008 to 2009. The federal funds rate is now hovering around 2.5 percent, with the Federal Reserve signaling that it will keep rates there for the time being.

Members of the Federal Reserve Bank of Boston set out to determine how persistently low rates affect the tolerance of public pension plans, particularly those that are underfunded, meaning the value of their assets is worth less than their obligations. In a research paper entitled "Reach for Yield by U.S. Public Pension Funds," published earlier this month, four members of the Boston

Fed, along with a member of the Board of Governors of the Fed, concluded that this combination of factors pushes pensions to take more risk.

The researchers used the Public Plans Database from the Center for Retirement Research at Boston College, pulling plan-level annual data from 2001 through 2016 for 170 public pension funds. According to the paper, 114 of those funds were administered by states, while 56 were administered locally. The sample covered 95 percent of public pension plan membership nationwide, the paper said.

The researchers estimated that one-third of public pension funds' total risk was related to underfunded status or low interest rates, research published on July 8 showed. The researchers found that risk-taking behavior related to underfunded status alone was responsible for about 12 percent of total risk taken on by the funds.
The researchers noticed that those low-interest rates and underfunded statuses, when combined, increased risky investing strategies.

"The effect of a lower funding ratio on risk-taking behavior was more pronounced when interest rates were relatively low," such as the period between 2012 and 2016, according to the research.

The public pension funds that were affiliated with states or municipalities that had weaker financial situations (higher levels of public debt or worse credit ratings) also took on more risk, the researchers showed.

If a state is allowed to default on its debt, public pension funds will often take on more risk, according to the research. The extra risk taken on by those public pension funds is essentially shifted onto taxpayers, who — if the state defaults on its debt — would pay the price, the research shows.

In other words, pension funds taking the most investment risk tend to be those on the most precarious financial footing.

"Risk-taking behavior is most pronounced among funds with sponsors with the least ability to bear additional risk," the paper showed.

Maryland Pension System's Assumed Rate of Return Reduced Again

The Board of Trustees of the Maryland State Retirement and Pension System (MSRPS) voted to reduce the System's actuarial assumed rate of return on its investments from 7.45% to 7.40%.

The System's lower rate will be effective beginning in fiscal year 2021.

"The Board's prudent action is in recognition of ongoing changes in the financial markets, while continuing to achieve the investment returns required for the system over the long term," says State Treasurer Nancy K. Kopp, chair of the MSRPS Board of Trustees. "Our goal is to continue to improve the strength of our retirement system and to keep our promise of a secure retirement that our members have worked so hard to earn in their years of service to the public."

The Board said it based its decision on an analysis by its actuary.

Among the 127 plans the National Association of State Retirement Administrators (NASRA) measured in 2017, nearly three-fourths reduced their investment return assumption since fiscal year 2010. NASRA found public plans that reduce their return assumption in the face of diminished near-term projections will experience an immediate increase in unfunded liabilities and required costs.

Researchers from the Center for Retirement Research at Boston College found a decline in assumed rates of return due to lower assumed inflation combined with a change in asset allocations, resulting in a higher expected real return, has increased long-term costs for public pensions. The researchers say the decline in assumed rates of return is due to lower assumed inflation, so the increase in costs is much smaller than if the decline in the assumed return was due to a lower assumed real return.

The Board of Trustees of the MSRPS reduced the system's assumed rate of return in 2013 to 7.55% from 7.75%. In 2017, it again reduced it from 7.55% to 7.45%.

Gov. Matt Bevin's Pension-Relief Bill Passes in the Kentucky House in a Close Vote

Gov. Matt Bevin's approach to providing relief to regional universities, health departments and other "quasi-governmental agencies" from crushing pension costs passed a crucial test on Monday when members of the Kentucky House approved the plan 52-46.

The narrow House vote was widely considered to be the toughest test for Bevin's bill, and it came after three hours of debate when minority Democrats argued the bill will slash pension benefits of many employees of the affected groups.

The bill now goes to the Senate, which is expected to pass it on Wednesday and send it to Bevin to be signed into law.

The General Assembly is meeting in a special legislative session, which Bevin called last week in order to pass the bill (/story/news/politics/kylegislature/2019/07/18/matt-bevin-issues-call-special-legislative-session/1765096001/).

The Monday vote illustrated the difficulty Bevin had in rounding up votes for his approach even though his fellow Republicans hold a 61-39 majority in the chamber.

Nine Republican House members joined Democrats in voting against the bill, including former House Speaker Jeff Hoover, of Jamestown; Rep. Robert Goforth of East Bernstadt, who was Bevin's opponent in the May GOP primary for governor; and Rep. Travis Brenda, a teacher from Cartersville.

At issue in the session is finding a way to give relief to nearly 120 quasi-governmental entities, including most mental health centers, spouse abuse and rape crisis shelters and child protection centers, from a staggering 70% hike in already high pension costs that took effect July 1.

"There are no good choices for this dilemma," said Rep. James Tipton, a Taylorsville Republican who sponsors the Bevin bill, noting that any relief to the affected groups comes at the expense of the troubled pension plan for state workers. "But if we don't pass this legislation and these agencies have to pay the full rate ... some of these agencies may shut down."

Bevin's bill would be retroactive to July 1 and delay the higher rates for a year. It also offers options to those groups to pay off their liabilities to the state pension plan — either in a lump sum or in installments over 30 years — and get out.

Opponents say the bill is written in a way that pressures the groups to take an option that requires them to freeze the accrued benefits of most current employees and move them into less generous 401(k)-like retirement plans for drawing future benefits.

"Those (employees) that are affected by this bill don't get to choose," said Rep. Chris Harris, D-Forest Hills. He said many of these employees have worked for years planning to get a pension offered to them when they were first hired.

"They are now going to find out that that's not going to be available. And that's what's wrong with this bill," Harris said.

But Rep. Jerry T. Miller, R-Eastwood, responded to critics: "I think what we're seeing is a lot of fear-mongering. In politics, we all know that fear will generate money and fear will generate votes."

Miller and other defenders of the Bevin approach said current law has allowed groups to exit the troubled state pension plan and take their employees with them. Moreover, they argued that in recent years, as pension costs for the state plan soared, many of the affected groups have laid off employees and contracted out services they had performed.

On Monday, Democrats tried to offer their alternative ideas, which would freeze the rate the groups must pay the pension fund at the pre-July 1 rate for 24 years. But House Speaker David Osborne, R-Prospect, ruled Democratic amendments out of order because they did not fit the narrow agenda set by Bevin for the session.

Steve Shannon, executive director of a community mental health center association, said later Monday, "We're very relieved the bill passed" because he said it was vital for the centers to get another year before being required to pay the higher rates.

He said the centers have some concerns about other aspects of the bill, but now have time to work with lawmakers in the hope of addressing those concerns in the 2020 regular session of the General Assembly.
Adam Caswell, vice president of government, corporate and foundation engagement at Northern Kentucky University, said, "This is a step in the right direction. It gives us the rate freeze. Now we'll look at the options and continue working with lawmakers and the governor."

Lawmakers passed a relief bill during the regular legislative session in March. But Bevin vetoed that bill because he said it contained an erroneous date and included an illegal provision. He said he would call a special session to pass a new version of the bill, which he unveiled in early May.

A special legislative session is estimated to cost taxpayers about $66,000 per day by the Legislative Research Commission.

Houston Firefighters Loses Appeal on Actuarial Assumptions

The Houston Firefighters' Relief and Retirement Fund has suffered a setback in its legal battle with the city of Houston over legislation it claims hurts the $4.2 billion fund. The Texas Court of Appeals affirmed Thursday a district court ruling that sided with the city in its use of its own actuarial assumptions to determine how much it should contribute to the fund.

The Houston firefighters claimed that a bill that the Texas Legislature passed in 2017 allowing the city to use actuarial assumptions different from the fund actuary's assumptions was unconstitutional.

"We are disappointed," Brett Besselman, the chairman of the Houston Firefighters' Relief and Retirement Fund board of trustees, said in a news release.

"This ruling, if upheld, would set the stage for perpetual shortchanging of firefighters' retirement benefits."

While the fund's board of trustees assumed a 7.25% rate of return on the fund's assets for its actuarial valuation report in May 2017, the city council passed a budget that used the Senate bill's assumed 7% rate of return, a discrepancy that caused the fund to sue the city, Mayor Sylvester Turner and other city officials.
The fund faulted the city for allocating less than half of the amount that should have been contributed to fund its pension obligations. In addition to punitively cutting firefighter benefits and altering the fund's funding mechanism, the bill breached the Texas Constitution by taking away the HFRRF board's right to select the actuarial assumptions to be used by the fund, it claimed in the lawsuit.

"We will continue our legal challenges because Senate Bill 2190 violates the constitutional requirement that pension boards set actuarial assumptions to avoid local political tampering," Mr. Besselman said.

The fund has sought to compel the city to allocate the funding it stipulated in its actuarial valuation report as well as a temporary and permanent injunction prohibiting the city and its officials from acting in reliance on the bill.

Private Sector

Court Decides Medical Center Plan is a Church Plan Under ERISA

Citing the Supreme Court decision regarding church plan cases and using a three-part test, a federal judge found the St. Elizabeth Medical Center Employees' Pension Plan falls under the ERISA exemption for church plans.

In a lawsuit challenging the church plan status of the St. Elizabeth Medical Center Employees' Pension Plan, a federal court judge has granted summary judgement to the medical center defendants.

The court previously ruled that the plaintiffs in the case had standing to sue on behalf of the plan since they had shown a substantial risk of harm by the plan's underfunding. U.S. District Judge David L. Bunning of the U.S. District Court for the Eastern District of Kentucky also dismissed claims against plan committee members regarding required reporting under the Employee Retirement Income Security Act (ERISA).

In his latest opinion, Bunning cites the U.S. Supreme Court decision regarding various church-plan cases in which it said ERISA Section 3(33) means that a church plan falls into the ERISA exemption if the plan is established and maintained by a church or association of churches or maintained by an organization with the principal purpose of administering or funding the plan. The defendants argue that the at-issue plan committee is such a principal-purpose organization.
According to Bunning, this principal-purpose organization statutory language has been distilled into a three-part test, which other courts have used to determine whether a plan maintained by a principal-purpose organization falls within the church-plan exemption:

- Is the entity a tax-exempt nonprofit organization associated with a church?
- If so, is the entity's retirement plan maintained by a principal-purpose organization? That is, is the plan maintained by an organization whose principal purpose is administering or funding a retirement plan for entity employees?
- If so, is that principal-purpose organization itself associated with a church?
  Bunning found the first portion of the three-part inquiry is satisfied. Among other things, he cited that St. Elizabeth is a tax-exempt nonprofit entity; St. Elizabeth was founded in 1861 by the Franciscan Sisters of the Poor and the property was acquired "in the name of this Catholic religious order;" sponsorship of St. Elizabeth was transferred to the Diocese of Covington in 1973, and continues to this day; the Bishop of Covington is the only

person with "the authority to dispose of hospital properties upon dissolution of St. Elizabeth;" and the governing documents of St. Elizabeth give the Bishop of Covington control over aspects of St. Elizabeth's operations and indicate clear association with the Catholic Church.

The plaintiffs suggest that the plan committee cannot be a principal-purpose organization because it is not, by definition, an "organization," according to the court opinion. However, Bunning looked to dictionary definitions of "organization" and found definitions merely require a group of people with a specific purpose. Bunning found that the plan committee meets the two requirements necessary for an entity to be an "organization" within the scope of the ERISA exemption. Bunning also used dictionary definitions of "maintain" and language of the plan documents to determine that the committee maintained the plan.

To determine whether the committee is a principal-purpose organization, Bunning looked at the language of the exemption which indicates that a principal-purpose organization is an "organization" with the "principal purpose" or "function" of "administering" or "funding" a retirement-benefits plan. While the defendants admit that the committee does not fund the plan, Bunning found that that the committee's principal purpose is "administration" of the plan. Looking to the plan documents, as he did in determining whether the committee "maintains" the plan, Bunning concluded that the committee's principal purpose is "administration." The plan document itself indicates that the objective and goal of the committee is to "manage and administer the plan." The resolution creating the committee indicates the same—that the objective of the committee is to "administer" the plan.
"As the Court previously found that St. Elizabeth is associated with the Catholic Church, and the Committee is an 'internal subset' of St. Elizabeth, the Court also finds that the Committee is associated with the Catholic Church and, therefore, satisfies the third prong of the test," Bunning wrote in his opinion. He found this conclusion is also supported by plan documents governing the committee, which say: "[t]he Committee shall consist of not fewer than three (3) members who believe in and follow the tenets of the Catholic Church," and indicate its role is to "administer the St. Elizabeth Medical Center Employees' Pension Plan in a manner consistent with the tenets of the Catholic Church."

Bunning dismissed other claims because it found ERISA does not apply to the plan.

FLASHPOINT: The DOL Finalizes MEP Regulations

As discussed in our FlashPoint dated October 25, 2018, available here: https://ferenczylaw.com/flashpoint-the-new-mep-meh-proposed-regulations/, the U.S.

Department of Labor ("DOL") previously introduced proposed regulations relating to certain defined contribution multiple employer plans ("MEPs"). These regulations were issued in final form on July 29, 2019 (the "Regulation"), and offer the ability of "bona fide" organizations, associations, and professional employer organizations ("PEOs") to offer closed MEPs to their participating employers.

The section of Employee Retirement Income Security Act of 1974, as amended ("ERISA") to which the new guidance relates is that which defines an "employer" for purposes of sponsoring a MEP. Under ERISA, a plan is an employee pension benefit plan only if it is established or maintained by "an employer, employee organization, or by both an employer and an employee organization." An employer is a person acting directly as an employer or acting indirectly in the interest of an employer in relation to an employee benefit plan. So, we must ask: what does that mean?

<u>What the Small Plan Community Wants to Know</u>

Continued Relief for Associations and PEOs, Not So Much for Open MEPs

As with the proposed regulations, the Regulation does not provide any relief for so-called "Open MEPs," particularly those that are sponsored by financial institutions and service providers for their clients. Such organizations are not considered to be "employers" under ERISA and so cannot sponsor MEPs. Open MEPs, therefore, will continue to be treated as groupings of single employer plans (with each adopting employer required to file its own Form 5500).

The DOL notes that it is, at least to some extent, anticipating the passage of legislation to deal with the Open MEP issues. However, chickens cannot be counted before they are hatched, so the preamble to the Regulation (the "Preamble") includes the statement that the DOL is "persuaded that Open MEPs deserve further consideration," but that it "does not believe that it has acquired a sufficient public record on, or a sufficiently thorough understanding of, the complete range of issues presented by the topic." As a result, the DOL is also requesting considerable input from the practitioner community regarding Open MEPs, as a prelude to considering further regulation.

References to AHP Regulations: Whistling Past the Graveyard?

The Regulation follows many of the roads carved out by the final regulations previously issued by the DOL in relation to Association Health Plans ("AHPs"). In fact, the Regulation refers often to the possible coordination by associations of their health plan offerings with their retirement programs, and how this coordination can result in greater efficiencies and savings for the participating employers. The AHP final regulations were struck down by the D.C. District Court in *State of New York v. U.S. Department of Labor* in March of this year, where the court found that the DOL had not reasonably interpreted ERISA in those rules. The Administration has appealed that court decision.

While the Preamble refers to the case in footnotes, and some of the structure of the Regulation reflects changes meant to resolve some of the elements of the court decision, the DOL also states in a footnote that it disagrees with the court's decision and references its appeal. Furthermore, the Regulation contains a "severability" clause, under which it is made clear that, if any part of the Regulation is found to be inappropriate, the balance of the Regulation remains.

<u>Here Are the Details for Those Who Are Interested</u>

Bona Fide Groups or Associations

The Regulation essentially adopts the proposed rules for MEPs sponsored by Bona Fide Groups or Associations (BFGAs). An organization qualifies as a BFGA (and thereby constitutes an organization that may sponsor a MEP) if it meets the following requirements:

- *While having a retirement plan may be the primary purpose for the group or association, there must be at least one other substantial business purpose unrelated to the plan.* The Regulation provides a safe harbor under which a substantial business purpose is considered to exist if the group or association would be viable in the absence of the plan. The business purpose may include promotion of common business interests or common economic interests of a trade or community, and is not required to be a for-profit activity. The Preamble notes that the "substantial" modifier is important: the business purpose must be of considerable importance to the organization. In a discussion that is reminiscent of Billy Crystal's character, Miracle Max, from "The Princess Bride," explaining the difference between "mostly dead" and "all dead," the Preamble acknowledges that it is hard to distinguish between "merely important" and "considerably important." The Preamble does not, however, give further guidance on this issue.
- *Each participating employer must have at least one employee who is a participant in the plan.*
- *The group or association must have a formal organizational structure with a governing body and bylaws or similar indications of formality.*
- *The group or association must be controlled by its employer members, and the participating employers (who are members of the group) must control the plan.* Control must be in both form and substance. In short, the plan is likely to be run by a committee of participating employers.
- *Plan participation is not offered to anyone other than employees or former employees of group or association members (and their beneficiaries).*
- *The group or association is not a bank or trust company, insurer, broker-dealer, similar financial entity, TPA, or recordkeeper.* The group or association also cannot be owned or controlled by such an entity or an affiliate of such an entity (except to the extent that such an entity is a member of the group or association).

Having met the above requirements for being a BFGA, there also must be a commonality of interest. This is demonstrated in one of two ways:

- The participating employers are in the same trade, industry, line of business, or profession; or
- Each participating employer must have a principal place of business in the same state or within the same metropolitan area, even if such area crosses state lines.

The Preamble includes a discussion of whether a trade or industry includes those who provide support or services to those companies. The Preamble notes by way of example an association of home builders, that would like to include plumbers, carpenters, and electricians. The Preamble provides that the DOL will not challenge any reasonable and good-faith industry classification or categorization adopted by an association, nor the inclusion of support or allied businesses in the fold.

Changes to the Proposed PEO Rules

As in the proposed regulations, the Regulation provides that Bona Fide PEOs may sponsor MEPs. However, the somewhat complex structure of the proposal, which distinguished between regular PEOs and those that have been certified by the IRS (so called CPEOs) [Okay, does anyone but me wish that these were C3POs? But I digress ….], has been abandoned in favor of a simpler standard without this differentiation. This simpler standard reduces the nine factors delineating a PEO as bona fide (as provided in the proposed regulations) down to merely four. The four factors needed to demonstrate that the PEO is a Bona Fide PEO require that the PEO:

- *Performs substantial employment functions on behalf of its client-employees and maintains adequate records relating to such functions;*
- *Has substantial control over the functions and activities of the MEP, as the plan sponsor, administrator, and named fiduciary, and continues to have responsibilities to the MEP participants after the client-employer no longer contracts with the sponsoring organization;*
- *Ensures that each client-employer that adopts the MEP acts directly as an employer of at least one employee who is a participant in the MEP; and*
- *Ensures that participation in the MEP is available only to employees and former employees of the PEO and its client-employers (whether current or former participants who entered during the period of the client-employer's contract with the PEO).*

For purposes of the first requirement, the determination of whether substantial employment functions exist is based on the facts and circumstances. However, the Regulation provides for a safe harbor. Under the safe harbor, the PEO is deemed to meet the substantial employment functions requirement if it:

- *Assumes responsibility for, and pays wages to, employees of client-employer adopters of the MEP without regard to whether the PEO is fully paid by the client-employer;*
- *Assumes responsibility for and reports, withholds, and pays any applicable federal employment taxes without regard to whether the PEO is fully paid by the client-employer;*
- *Plays a definite and contractually specified role in recruiting, hiring, and firing workers of the client-employers who adopt the MEP in addition to the role in such functions played by the client-employer (The Preamble spends some amount of time explaining this requirement with, in our opinion, very little success. But, what the DOL is apparently looking for is a situation in which both the client-employer and the PEO have some responsibility in hiring and firing, even if the PEO simply ratifies the intended actions of the client-employer.); and*
- *Assumes responsibility for and has substantial control over the functions and activities of any benefits the service contract requires the PEO to provide, without regard to whether the PEO is fully paid by the client-employer for these benefits.*

The Working Owner Rules: When a Self-Employed Individual Constitutes an Employee

As noted earlier, the MEP requires that each participating employer have at least one employee participating in the plan. Does a self-employed owner of an incorporated business count as such an employee? Yes, says the DOL, if such individual constitutes a "working owner," who is someone who:

- *Has an ownership interest of any nature in a trade or business, whether incorporated or not, including partners or other self-employed individuals;*

- *Earns wages or self-employment income from the trade or business for providing personal services to the trade or business; and*

- *Who either:*
  - *Works at least 20 hours per week or 80 hours per month providing services to the business; or*
  - In the case of a MEP sponsored by a BFGA, has wages or self-employment income from such trade or business that at least equals the working owner's cost of coverage for participation by the working owner and its covered beneficiaries in any group health plan sponsored by the BFGA in which the working owner has a right to participate.

There is discussion in the Preamble about the hours-per-week or -month requirement. Commentators noted that some businesses, such as construction, can be quite cyclical. In those circumstances, it is possible that a business owner might have periods of low hours and low pay.

The DOL agrees that averaging of hours of service or compensation over a reasonable period of time is appropriate in those circumstances, but declines to give specific guidance.

The Regulation also notes that the status of the working owner needs to be disclosed at the outset of the participation in the MEP and evaluated over time. The Regulation also notes that the working owner rules do not apply to PEO participation. Companies with no rank-and-file employees generally have no need for a PEO; therefore, there must be at least one rank-and-file employee for a working owner to participate in a PEO MEP.

Other Issues

The Preamble and the Regulation both note that an employer adopting into a MEP bears fiduciary responsibility for deciding to provide benefits through the MEP, and for monitoring the MEP by obtaining and reviewing reports from the MEP administrator. The DOL notes, however, that the MEP sponsor (i.e., the BFGA or PEO) is the plan administrator, with the myriad responsibility that goes with that title.

The Preamble discusses situations where a participating employer severs its relationship with the BFGA or the PEO. At such point, the requirement that only member-employers be participating employers ceases to be met. In what is an excellent resolution of this problem, the DOL notes that there is no issue at all if the former employer-member ceases to make ongoing contributions to the MEP. In that case, the MEP and its plan administrator still owe responsibilities to the former employer-member's participants, as would any plan administrator to terminated participants. Presumably, the former employer-member will take action to spin off its part of the plan from the MEP.

However, if the former employer-member instead continues to contribute to the MEP, acting as if the participation is ongoing, the part of the plan on behalf of the former employer-member becomes its own single employer plan, and the balance of the MEP remains a multiple employer plan.

Finally, commentators asked the DOL to confirm that so-called "corporate MEPs"—that is, plans sponsored by employers with participating employers that have some common ownership but that is insufficient to constitute a controlled or affiliated service group—are closed MEPs. The DOL declined to do so, leaving this topic as one of the issues on which it is requesting more information.

Conclusion

As we originally stated when the proposed regulation was issued, if you are looking for guidance regarding Open MEPs, there is nothing in this finalized Regulation that will give you satisfaction.

There is, of course, some solace to be taken from the fact that even the DOL seems to be hoping for legislative relief, and that it is at least contemplating Open MEP guidance if the legislation does not pass. But, for now, it is all still aspirational in nature.

On the other hand, PEOs can rejoice, as the DOL is finally giving them a roadmap to closed MEP sponsorship. When added to the relief issued earlier in the month from the failure to comply with the reporting and disclosure obligations applicable to MEPs in relation to Forms 5500 and lists of participating employers, July 2019 has been a good month for PEOs.

Last, but assuredly not least, if you are one of the entities setting up MEPs for Chambers of Commerce, you should take encouragement from the fact that the DOL refers to Chambers of Commerce as potential BFGAs at least three times within the Preamble.

Corporate Plans Hurt by Interest-rate Forecasting GSAM Says

U.S. DB plan executives waiting for long-term interest rates to rise find themselves underhedged and more susceptible to falls in rates.

U.S. defined benefit plan executives waiting for long-term interest rates to rise are finding themselves underhedged and more susceptible to rate decreases, said a midyear review of corporate pension plans from Goldman Sachs Asset Management.

At the beginning of 2019, the report showed most investors thought 30-year government bond yield would rise to 3.51% from 3.02% in 2018. But the actual yield as of June 30 was 2.53%, a full 98 basis points below that estimate.

Mike Moran, GSAM's senior pension strategist and author of the review, said in a telephone interview that many of their clients have been waiting for rates to rise for a very long time. But the falling rates "just increases the value of the liabilities and has a depressing effect on funded levels," Mr. Moran said.

However, despite the fall in rates, the review estimates the aggregate funding ratio of U.S. corporate defined benefit plans rose to 88.5% at the end of June from 86.7% at the end of 2018 thanks to phenomenal returns, Mr. Moran said.

The estimated 6.6 percentage-point drop in that aggregate funding ratio as a result of actuarial losses in addition to a 1.7-point drop due to interest costs and 0.6 points in service cost were more than offset by a whopping 10.1 percentage-point rise thanks to asset returns. Contributions also accounted for a 1 percentage-point increase.

Despite the higher investment returns, Mr. Moran said sponsors are "nervous about everything."

"They're worried about 'what are future-looking returns going to be?' "Mr. Moran said. "I think they're worried about everything because a lot of asset classes look expensive, or rates are going to lower more. There's a lot of concern that sponsors have both on the asset and liability sides of the equation."

He also said that clients overall are acknowledging that forecasting interest rates is a "difficult thing to do." Mr. Moran says in the review that clients have talked more about using derivatives and leverage to increase hedge ratios without diverting capital from return-seeking assets.

Some of that activity is due to clients realizing that forecasting interest rates is clearly not a core competency, the review said.

The review showed that since 2014, estimates of how the 30-year government bond yield would land at the end of each year have all been too high.

Plaintiffs Claim Victory in First Ruling Challenging DB Plan Actuarial Assumptions

As detailed in our alert last month, two plaintiffs' law firms have filed a flurry of putative class-action lawsuits challenging the calculation of "optional forms" of benefits (*i.e.*, non-single life annuities) and early retirement benefits under defined benefit pension plans. The firms have now filed nine lawsuits, all generally alleging that the mortality table (although, in some cases, plaintiffs also challenge the plan's interest rate) that is used to calculate participants' early retirement or optional forms of benefits is not reasonable because it is outdated. The use of an outdated mortality table, plaintiffs argue, produces early retirement or optional forms of benefits that are not "actuarially equivalent" to a single life annuity at normal retirement age (the default benefit under ERISA). Plaintiffs seek the difference between their benefits as calculated under the plan and their benefits as calculated using allegedly reasonable actuarial assumptions—generally, the assumptions set forth in the Treasury regulations pursuant to Internal Revenue Code ("Code") section 417(e)(3).

Defendants in many of these lawsuits have filed motions to dismiss, and more motions are expected. The U.S. district court in Minnesota in *Smith v. U.S. Bancorp*, however, is the first to decide on a motion to dismiss.

In *Smith*, the plaintiffs, each of whom retired before normal retirement age of 65, filed an action against U.S. Bancorp, the Employee Benefits Committee, and unnamed fiduciaries (collectively, "U.S. Bancorp") challenging the U.S. Bank Pension Plan's ("Plan") "early commencement factors" ("ECF") used to calculate early retirement benefits. Depending on the age at which a participant retires, the plaintiffs allege that a participant could receive between 38 percent and 90 percent of his or her normal retirement benefit. These ECFs, the plaintiffs argue, unreasonably reduced plaintiffs' benefits such that their early retirement benefits were not actuarially equivalent to their normal retirement benefits in violation of ERISA. As in the other lawsuits, the plaintiffs seek declaratory and equitable relief, as well as benefits under the plan after the plan is reformed. The plaintiffs also bring fiduciary breach claims against the defendants for either failing to administer the Plan in accordance with ERISA or, in the case of the company, failing to monitor the fiduciaries administering the Plan.

Below we review the arguments raised in support of and opposing the dismissal of plaintiffs' claims, and the court's ruling denying the motion.

U.S. Bancorp's Motion to Dismiss

In its motion to dismiss, U.S. Bancorp made six principal arguments, many of which are similar to arguments made by other defendants in these lawsuits:

1. <u>No standing to enforce Treasury regulations</u>. There is no private right of action to enforce the Code and related Treasury regulations that are the basis for the plaintiffs' claims that the ECFs must be calculated using "reasonable" actuarial assumptions. Similarly, ERISA section 502(a)(3) does not authorize actions to enforce the Treasury regulations.

2. <u>Nothing in ERISA requires the use of reasonable actuarial assumptions</u>. There is no requirement under ERISA that assumptions used to calculate early retirement benefits be "reasonable," nor did Congress prescribe any particular assumptions that must be used. This is in contrast to elsewhere in ERISA where Congress did impose a reasonableness requirements (*e.g.*, in the calculation of withdrawal liability) or specific actuarial assumptions (*e.g.*, in calculating lump sum benefits).

3. <u>Plaintiffs did not sufficiently allege that the ECFs are not reasonable</u>. Even if there is a "reasonableness" requirement under ERISA, the plaintiffs' complaint did not contain sufficient allegations that the Plan's ECFs are outside the range of reasonableness. Comparing the Plan's ECFs to ECFs calculated using other assumptions does not alone establish unreasonableness.

4. <u>Plan reformation is unavailable under ERISA section 502(a)(1)(B)</u>. Reformation is an equitable remedy that is unavailable under ERISA section 502(a)(1)(B), which generally only allows a participant to sue for benefits under the terms of the Plan.

5. Plaintiffs failed to plead a failure to monitor claim. Nowhere in the complaint did plaintiffs allege that U.S. Bancorp had a duty to monitor (*e.g.*, no allegation that it had the authority to appoint and remove fiduciaries).

6. Plaintiffs' claims are time-barred. Plaintiffs' claims are time-barred by the Plan's 30-month statute of limitations, and, with respect to the plaintiffs' fiduciary breach claims, by ERISA's 6-year statute of limitations. Plaintiffs knew or should have known of the allegedly unreasonable ECFs in 2002 when the ECFs were adopted or, at the latest, in 2003, when the Plan document containing the ECFs was published.

The Court Denies U.S. Bancorp's Motion to Dismiss

The court issued an opinion in late June denying U.S. Bancorp's motion to dismiss. The court sided with the plaintiffs in finding that the plaintiffs' claims are for actuarially equivalent benefits under ERISA, and are not claims under the Code or Treasury regulations. The court adopted the plaintiffs' argument that, instead, the Code and Treasury regulations provide guidance as to the meaning of ERISA's actuarial equivalence requirement.

The court went on to state that U.S. Bancorp is incorrect that there are no requirements under ERISA for calculating and applying the ECFs to produce actuarially equivalent benefits, and that there is case law to suggest that "two methods of payment are actuarially equivalent when their present values are equal under a given set of actuarial assumptions." The court suggested that "in determining the present value of any distribution of any accrued benefit from a defined benefit plan, the plan must take into account specified valuation rules as set forth in section 417(e)." The plaintiffs allege in the complaint that the ECFs are not calculated in accordance with these requirements; therefore, the court held that the claims cannot be dismissed.

With respect to the fiduciary breach claim against the company, the court cursorily held that plaintiffs sufficiently pled the claim. As to the claims' timeliness, the court noted that a case is generally not dismissed under Federal Rule of Civil Procedure 12(b)(6) on the basis of a potential statute of limitations defense. In any event, the court found that there are factual disputes regarding whether the Plan's limitation period applies and on what date any limitations period began to run.

Groom's Analysis

As noted above, the *Smith* decision denying U.S. Bancorp's motion to dismiss is the first with respect to the motions to dismiss filed by defendants in these lawsuits. Accordingly, although the *Smith* court's decision is a setback for U.S. Bancorp, the decision also was likely a disappointment for the defendants in the other 8 lawsuits, and for plan sponsors that are concerned they could be targeted next. And while it is unclear whether the *Smith* decision will influence courts deciding motions in other of these cases, the plaintiffs in those cases are certainly trying to get as much momentum from the decision as possible. Indeed, the plaintiff in *Herdon v. Huntington*

Ingalls Industries, Inc. et al., in his opposition to the defendants' motion to dismiss, cited *Smith*, stating that the court held that ERISA's actuarial equivalence requirement requires the use of current interest and mortality assumptions.

Additionally, the plaintiffs' apparent win in the *Smith* case could embolden the plaintiffs' law firms to file additional complaints against other plan sponsors and fiduciaries. Not only did the decision likely give plaintiffs a shot of optimism (whether founded or not) that these cases will move to discovery (and, thus, increasing the chances of settlement), but plaintiffs read the *Smith* court's opinion as requiring the use of current interest rate and mortality assumptions. With that view of the law, the plaintiffs' firms will be incentivized to file as many lawsuits as possible challenging plans with assumptions that do not match the current Treasury regulations.

We continue to monitor these cases and will review each decision on these motions to dismiss as they come down. If you have any questions about these cases or the claims raised by these plaintiffs' firms, please contact the authors or your Groom attorney.

PBGC's Missing Participants Program for Defined Contributions Plans

Did you know that the Pension Benefit Guaranty Corporation (PBGC) administers a missing participants program for defined contribution plans? We ask because PBGC has indicated, informally, that few defined contribution plans have taken advantage of this program.

Missing Participants Program

In the benefits community, it is well known that PBGC administers a termination insurance program applicable to most defined benefit pension plans, and that, upon termination, a defined benefit pension plan may be required to participate in PBGC's Missing Participants Program.

Less well known is that, if a defined contribution plan (DC Plan)[1] terminates on or after January 1, 2018, that plan voluntarily can participate in PBGC's Missing Participants Program. The goal of the program is to connect missing participants with their benefits. Although the program is referred to as the "Missing Participants Program," it applies also to missing beneficiaries and to "unresponsive" individuals whose address is known, but who, upon plan termination, fail to fill out necessary paperwork or to accept a lump sum payment.[2]

A terminating DC Plan can choose to participate in the Missing Participants Program as a "Transferring Plan" or as a "Notifying Plan." A Transferring Plan must transfer to PBGC the account balances of all Missing Participants. A Notifying Plan participates by sending information to PBGC about the financial institution or unclaimed property fund to which the Missing Participant's DC Plan account balance has been transferred. A Notifying Plan may choose to notify PBGC with respect to some or all Missing Participants.

Fees

1. Transferring Plans. PBGC charges a one-time $35 administrative fee for each Missing Participant whose payment obligation of more than $250 is transferred to PBGC. PBGC does not charge a fee for transferred payment obligations of $250 or less.

2. Notifying Plans. Notifying Plans are not charged a fee.

Distributions

1. Distributions from DC Plan to PBGC. Amounts transferred to PBGC pursuant to the Missing Participants Program will not be treated as taxable distributions subject to withholding or reporting.

2. Distributions from PBGC to Missing Participants. When a Missing Participant is located, the PBGC will offer that Missing Participant a lump sum payout and, if the benefit is in excess of $5,000, the PBGC also will offer payment in the form of an annuity.[3] Tax-free rollovers (e.g., into a qualified retirement plan or IRA) also are available.

Timing

The latest date for submitting a Missing Participants filing to PBGC (and for payment of any monies owed to PBGC) is 90 days after the later of (i) the date all distributions have been made to individuals who are not Missing Participants, or (ii) one year after the plan termination date.

Within nine months before submitting a Missing Participants filing to PBGC, a DC Plan must conduct a diligent search for Missing Participants. For this purpose, a diligent search is one that satisfies regulations and other applicable guidance issued by the U.S. Department of Labor.

Flexibility

The Preamble to the Missing Participants regulation explains that, because "it is impossible to anticipate and appropriately provide for every state of events" the PBGC is authorized "to grant waivers, extend deadlines, and in general adapt to unforeseen circumstances, with the proviso that similar treatment be given to similar situations."

Advantages

Fiduciaries of terminating DC Plans may determine that it is in the best interest of DC Plan participants for the DC Plan to participate in PBGC's Missing Participants Program. Advantages of participation include the following:

1. Notifying Plan. Without paying a fee, a terminating DC Plan can add a Missing Participant's name to the PBGC database, making it more likely that the Missing Participant will be reunited with his or her DC Plan benefits.
2. Transferring Plan. DC Plan benefits transferred to PBGC are not subject to ongoing administrative fees. [4]
3. Search. PBGC will conduct periodic searches for Missing Participants

For more information about PBGC's Missing Participants Program for terminating DC Plans, you can contact PBGC by phone at (800) 453-9584 or by email at: MissingParticipants@pbgc.gov. You can also contact one of our benefits attorneys.

[1] In this article, the term "DC Plan" refers to 401(k) plans, profit sharing plans, money purchase plans, target benefit plans, employee stock ownership plans, stock bonus plans, and 403(b)(7) plans subject to Title 1 of ERISA. Examples of plans not included in this definition because they are not covered by PBGC's Missing Participants Program are governmental plans, church plans, and plans that cannot pay benefits to PBGC in cash. See, 29 CFR 4050.201 of PBGC's Missing Participants regulation for more information.

[2] In this article, we use the term "Missing Participant" to refer to missing participants, to missing beneficiaries and to "unresponsive" individuals as described above.

[3] Annuities are offered regardless of whether the terminated DC Plan contained an annuity distribution option.

[4] If the Missing Participant's benefit is paid as a lump sum, it will be credited with interest at the Federal mid-term rate. If the Missing Participant's benefit is paid as an annuity, it will be converted using assumptions under Internal Revenue Code Section 417(e)(3).