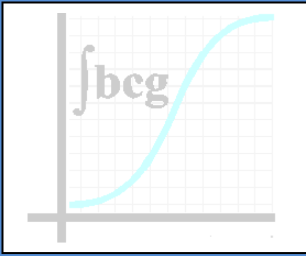

BCG Retirement News Roundup

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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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Public Sector/Government Plans

Rhode Island City's COLA Freezes Upheld by State Supreme Court

Freezes to cost-of-living adjustments imposed on some retired police officers and firefighters by the city of Cranston were upheld by Rhode Island's Supreme Court.

The opinion, written on June 3 by Chief Justice Paul Suttell in Providence, upholds a 2015 state Superior Court ruling that the city's financial crisis warranted freezing the COLA adjustments to their retirement benefits, despite contractual rights to those benefits.

In 2013, the Cranston City Council enacted a 10-year freeze on COLA adjustments for employees of the Cranston Police and Fire departments, which Cranston Mayor Allan Fung said was necessary to prevent the $70.6 million Cranston City Police and Fire Department Pension Plan from becoming insolvent. A lawsuit by police and fire retirees challenging the freeze led to a settlement agreement to freeze COLAs every other year for the first 10 years, and then cap them for another 20 years.

That settlement was challenged by 70 retirees who opted out of the settlement and formed the Cranston Police Retirees Action Committee to sue the city, the mayor and the city council, arguing that the freezes were a breach of contract and that the city had a history of underfunding the pension fund, among other claims.
After losing the initial round, the plaintiffs appealed, challenging several of the trial judge's pretrial decisions, some findings and conclusions after trial, and the post-trial award of costs in favor of the city. A key argument in their appeal was that the 2013 ordinances violated the contract clause of the U.S. and Rhode Island constitutions.

The state Superior Court affirmed the judgment in favor of the defendants on all counts and denied the plaintiff's motion for a stay.

Calling it an "extremely close" case, Mr. Suttell upheld the Superior Court decision "with a decided lack of enthusiasm and only after prolonged research and reflection and hesitation," he said in an order that noted the lower court's "impressively Herculean effort to summarize the complex factual background that the case involves."

Mr. Suttell said that relevant precedent compelled him to concur because of the city's unanticipated fiscal crisis and because the COLA impairment is temporally limited. "In my heart of hearts, I think that we, as a nation and as a state, have strayed far from what the Contracts Clauses were clearly meant to prohibit, i.e., any law impairing the

obligation of contracts," he wrote.

Mr. Fung called the decision historic, making Cranston "the first government entity in Rhode Island to reform its troubled pension system while withstanding a full legal challenge."

The "narrowly tailored" reforms will save taxpayers more than $6 million annually and ensure the long-term solvency of the police and fire pension plan, Mr. Fung said in a statement. "As mayor, I have ensured that we fully funded our (annual required contribution) and 100% of our (other postemployment benefits) obligations so that we are doing right by our workers," he said.

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America’s Largest Musicians’’ Union Announces Pension Cuts

Trustees of the American Federation of Musicians and Employers' Pension Fund (AFM-EPF) announced the evening of May 24 that they will apply to the U.S. Treasury for a reduction in member benefits, due to the AFM-EPF's "critical and declining" status – meaning the fund is projected to run out of money in 20 years. The AFM represents 80,000 professionals in the United States and Canada who play in symphony orchestras and opera houses, on Broadway, in film and television, and on studio recordings. Approximately 50,000 AFM members participate in the pension fund, and it's estimated that 20,000 of them will eventually see a reduction in their pension benefits.

"The pension is a symptom of a much bigger problem with the AFM and what was going on at Local 802," says Adam Krauthamer, the newly elected president of the New York local and the executive director of Musicians for Pension Security, a group which is educating musicians and trying to find solutions to this issue. "The musicians' national union has seen large drops in membership, less and less work under contract. And, seemingly, for musicians my age," says the 38-year-old, "there was no real serious effort to address changing the future."

As of March 2019, the fund had assets of $1.8 billion, versus liabilities of $3 billion, putting the AFM-EPF at a critical 60% funding threshold. Because of that change in status, the funds' trustees have applied to the U.S. Treasury using the Multiemployer Pension Reform Act (MPRA) in order to reduce members' benefits and try to prevent insolvency.

"Although reducing earned benefits will be painful," a statement on the fund's website

reads, "the Trustees have decided to apply to do so because it is better than the alternative, which is running out of money and leaving everyone with almost no benefits." The changes will not happen immediately – regular benefits will be paid during the MPRA application process, and the changes aren't expected to go into effect until late 2020 or early 2021. The AFM-EPF is also campaigning for congressional legislation to protect 120 similarly situated multiemployer pension funds from insolvency. "The stakes are too high to avoid taking action, while we wait for Congress to act," the fund's statement reads.

"This is going to have devastating effects on our community," says Cenovia Cummins, a violinist who's been freelancing on Broadway and in orchestras around New York since the mid-1980s. "To work as hard as you do and then be told you don't have a retirement... You don't want to get older with so much uncertainty in your life. People in my age bracket are going to see the deepest cuts. All the money we've put into this pension and it not being there... It's such a betrayal."

The greying of the union has had a major impact on the pension fund. According to the fund's FAQ page, it's "a mature plan, with the retiree population having grown faster than the active population, which means that benefit payments are growing faster than contributions. While the union has bargained additional contributions into the Fund, it is not enough to avoid running out of money." In the fiscal year that ended March 31, 2018, the fund paid out $171 million in benefits, but only received $68 million in pension contributions. In a statement to NPR, the pension fund writes, "This negative cash flow is projected to continue — and worsen. Every year, if investment returns are not able to make up this shortfall, the Fund has to draw down assets, which leaves less of an asset base on which to generate investment returns the following year."

Another part of the problem is lingering fallout from the 2008 economic downturn, when the fund lost 40% of its value in just 18 months — according to Adam Krauthamer, somewhere in the vicinity of $800 million. Still, while most pension funds have turned themselves around in the years since, the AFM-EPF has been a laggard, he claims. "From 2008 to 2018, that 10-year period, according to our own trustees' documents and consultants, we ranked dead last. We were in the 99 percentile out of 100. I think our investment return net of just investment fees was 3.2%. And we have incredibly high administrative fees." The Fund disputes that figure, quoting an average annualized return of 9.4% (based on a lower amount of assets post-downturn). Regardless, a class-action lawsuit filed in 2017 alleges that fund managers took a series of risky investments to counter the losses after the downturn, which trustees claim has "no merit."
The Musicians for Pension Security website offers a comparison between the AFM-EPF and the AFTRA pension fund, which are similar in size: Between 2009 and 2014, the

musicians' fund paid $50 million more in expenses and fees than the AFTRA fund. Per the fund, this comparison is inaccurate: "The AFM-EPF has more than twice as many employers, several times more collective bargaining agreements and several thousand more participants."

In fact, the pension crisis is one reason that Krauthamer, a French horn player with multiple Broadway credits, was elected following an insurgent campaign in 2018. Local 802 represents musicians at the New York Philharmonic, Metropolitan Opera and on Broadway, among other places, and its members voted by a two-to-one margin to have Krauthamer replace the incumbent, Tino Gagliardi. (Gagliardi still remains a trustee of the pension fund.)

Not all pension participants are expected to receive reduced benefits. Because of MPRA protections, participants who are 80 and older, as well as those receiving disability pensions, will not see any reductions. Between 75 and 79, there will be a sliding scale, to determine partial reductions. Those protections also apply to survivor benefits. But for 40% of AFM's members — its younger population — the reductions determined by the MPRA process will become permanent.

As president of Local 802, the largest local in the union, Krauthamer is trying to effect change on a national level, with some proposals for the upcoming AFM convention, led by national president Ray Hair, in June. "We have a proposal to bring two experts onto the board of trustees; one in actuarial science, one in finance," he says, "I think that that could significantly help us. We've proposed that the fund start holding regular meetings. We propose them trying to increase employer contributions, which we're trying to do ourselves here in New York. We'll see what happens."

The bottom line, Krauthamer says, is "it affects all musicians. Some more than others, but it is something that if we don't address, you know, my generation is not going to have the same future as the generations ahead of us. And frankly, the generations ahead of us are really looking at serious cuts to benefits at the end of their careers. And to say it's unfair is an understatement. I mean, this wasn't a gift. This was money that was earned, that was taken out of their wages. And now we're simply at a point where we're calling for accountability, transparency and change around the fund."

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CalSTRS's Plan to Reduce Fees

The California State Teachers' Retirement System (CalSTRS) is initiating a long-range plan to increase internal management of assets to reduce the $1.8 billion it currently pays out in

external management fees:

The effort for cost savings comes at a critical time for CalSTRS, the second-largest US retirement plan.

The plan is only 65.5% funded as of June 30, 2018, a number that is expected to drop after the plan posts its investment returns for this fiscal year at the end of next month. It has been a volatile year for pension plans primarily due to the ups and downs of the stock market. Few, if any, plans are expected to meet their anticipated rates of return.

CalSTRS's expected rate of return each year is 7%, a rate some critics say is unrealistic. In any case, saving external fees by increasing internal management can give CalSTRS a better chance of meeting its returns projections, argue investment staffers.

According to the article, CalSTRS has made the largest progress in internal management in its $28.3 billion fixed income portfolio where 85% of the assets class is internally managed, as well as in the $119.5 billion global equity portfolio, where around 50% is managed internally.

The largest group of fees paid to external managers in 2017 was in private equity where $521 million was paid in management fees and carry (profit sharing).

CIO Chris Ailman has said that it would be difficult for CalSTRS to run its own direct equity program in a way similar to the way Canadian pension plans do, but he has advocated taking a first step by building the private equity co-investment program, in which pension plans can invest alongside equity general partners, often with no fees or carry.

Ailman is absolutely right to focus on building out the co-investment program. Investing alongside general partners on larger transactions is how Canada's large pension funds were able to maintain their allocation to private equity while lowering overall fees.

But developing a co-investment program requires internal expertise and this means hiring and paying people with specialized skill sets who can quickly analyze co-investments and invest in the requisite time frames general partners set which is often short notice.

CalPERS, the other giant California pension fund, just hired Greg Ruiz as managing investment director for private equity. Ruiz was previously a principal at Altamont Capital Partners, a private equity firm based in Palo Alto, California, according to a statement from CalPERS.

CalPERS currently has around $28 billion invested in private equity and sees further investment in the asset class as instrumental to achieving its 7% return target. Its CIO, Ben

Meng, discussed the new private equity platforms with me back in March and they're proceeding cautiously, even seeking ideas on this initiative.

In a recent board meeting, Meng fielded questions from investment committee members as to why co-investments at CalPERS had stopped. He said the entire program was under review and that it was prudent to stop co-investments as part of the overall review.

He also told the investment committee that the new co-investment program must have a steady deployment of money each year, irrespective of market cycles, stating credibility with investment partners will be enhanced by a quick and consistent approval process for co-investments.

He's absolutely right, quick turnarounds are critical to the success of a co-investment program, and the board has to respond in a timely fashion.

This is why Canada's large pensions have built successful private equity co-investment programs, they don't always need board approval for every transaction and when they do, they get quick responses.

Lastly, I note that in fiscal 2019, CPPIB generated $32 billion of net income from operations after all costs, incurring operating expenses of $1,203 million, $1,586 million in investment management fees paid to external managers, and $477 million of transaction costs.

Think about it, CPPIB has a total of $392 billion in assets and pays out $1.59 billion in investment management fees, which is less than what CalSTRS or CalPERS pay out in external management fees (and that's Canadian dollars).

The same thing goes for AIMCo, CDPQ, OTPP, OMERS, PSP and BCI. They have all developed co-investment programs to manage the bulk of the assets internally, realizing substantial savings while delivering great long-term results.

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Connecticut Police Department Reverses Course, Switches Back to DB Plan

The town of Branford, Conn., police department is switching back to its $24 million defined benefit plan from a defined contribution plan.

The town of Branford, Conn., police department is switching back to its $24 million defined benefit plan from a defined contribution plan following a vote at a town meeting Tuesday, town Finance Department Director James Finch said.

The town of Branford and United Public Service Employees Union agreed to have the Branford Police Department switch to a DC plan in 2011, said a memorandum given to Pensions & Investments by Mr. Finch. The switch was made after the 2008 global financial crisis and also because the town wanted to mitigate investment risks.

Although the DC plan initially appeared to meet the town and its officers' needs, participants became concerned that the plan wouldn't provide sufficient benefits if they became disabled. Plus, the police union was the town's only bargaining unit not covered by a DB plan. These factors contributed to higher turnover rates within the police department.

Participants will not stay in the DC plan as the revised pension agreement mandates they move into the DB plan, Mr. Finch in an email. The DC assets will be transferred into the DB plan as they will be used to offset the liability. Further, DC participants will receive credit in the DB plan from their dates of hire.

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Four Challenges Pension Administrators Face

Well-run retirement plans are an important reason why talented employees join the public sector workforce. In a 2018 Accenture survey of 2,800 public and private employees, 78 percent said pension benefits are critical to accepting employment and 73 percent stay with an employer because of the retirement benefits offered.

“Legislators and the general public often don’t adequately understand the overarching challenge that the public sector faces to attract the professionals we rely on to perform essential services, such as teaching our children, policing streets or protecting the public,” says Keith Brainard, research director at the National Association of State Retirement Administrators, a nonprofit group that represents state and territorial public retirement systems. “Retirement benefits are a vital part of filling those roles.”

Administrators at the largest state-run pension programs are no strangers to challenges — for decades they’ve serviced hundreds of thousands of members and overseen millions of dollars in benefits. But even these seasoned professionals say nothing compares to the challenges that have intensified over the last decade due largely to four key factors.

1. Growing Structural Complexity

Lawmakers have initiated a series of reforms designed to shore up the financial viability of retirement programs. As a result, today's retirement systems often manage multiple types of retirement plans. Many pensioners are still covered by traditional defined-benefit plans, which use salary histories, tenure and other factors to determine the payout they'll receive when they retire. With newer defined-contribution plans, however, employees contribute chosen amounts to their retirement accounts over time and may receive matching funds from employers. Because account totals change based on contribution levels and investment returns, the total amount of available funds at retirement is harder to predict.

Some pension organizations also offer hybrid plans that combine characteristics of these two options. In addition, there are differing benefits structures depending on when employees were hired, which departments they work for and which options they've chosen within their retirement plans. And pension rules never die; reforms always add complexity on top of the existing complexity.

"In the era of pension reform, structural changes and new plan designs have significantly increased complexity for administrators," says Patricia Bishop, director of the Virginia Retirement System, which manages benefits for 706,000 state employees, state police and correctional officers, judicial branch retirees, teachers and employees of most of the commonwealth's local governments and political subdivisions.

2. Changing Roles for Administrative Staffs

The shift toward defined-contribution plans — which require participants to take an active role in retirement planning since the amount and timing of their contributions directly determine how much money will be available when they retire — is fueling employee demand for financial education.

"Because these types of plans require employees to be more engaged in building a financially secure retirement, we're helping our members learn about their benefits so they can make good decisions as it relates to their retirement," says Kerrie Vanden Bosch, director of Michigan's Office of Retirement Services, which counts more than 550,000 active members and retirees across five different systems. The systems have $80 billion in assets and pay out about $7.3 billion in pension and healthcare benefits annually.

In Michigan and elsewhere, administrators are finding ways to support defined-contribution plan participants. For instance, plans may automatically enroll eligible employees and include defaults that set contributions at a level where workers receive a full employer match.

In Michigan, employee contributions automatically increase by one percent a year up to 15 percent, unless enrollees opt out of the automatic increases.

“We try to work with the inertia of some members so they can be successful even if they’re not fully engaged with their retirement plan,” Vanden Bosch says.
But as retirement plan members seek greater insights, administrators may find themselves in a difficult position. Virginia’s Bishop emphasizes that there’s a difference between education about retirement planning and offering specific financial and investment advice for members.

“We’re pushing relevant information to help members understand the power of compound interest and why it matters to start saving early,” she says. “We’re showing them the opportunities that come from adjusting their retirement plan and contributions over time.”

To do that, the program creates quizzes to test and improve employees’ financial expertise. Participants can earn digital badges for improving their financial wellness. In addition, the Virginia Retirement System offers an online financial planner, tools that model benefits outcomes based on individual contributions and information about what steps participants can take to meet their retirement goals.

For example, participants in defined-contribution plans who aren’t taking the maximum amount out of their paychecks may see a pop-up screen when they log into their online portal. The message points them to information that discusses the value of a larger contribution.

“We’ve had great success with this initiative,” Bishop says. “About 31 percent of the participants who saw the splash screen increased their voluntary contributions.”

3. New Customer Engagement Demands

Participant expectations for interacting with pension programs are evolving rapidly, influenced by what citizens experience online with commercial retailers and other sophisticated online businesses.

“To meet these expectations, pension programs must improve their ability to support a range of digital interactions on the Web, with mobile apps and through social channels. But many plan administrators have been slow to invest in digital technologies, often because pension systems don’t compete for customers the way commercial businesses do,” says Owen Davies, global managing director of the pension practice for Accenture, a management consulting firm. “This attitude misses the fact that retirement systems are competing for the attention of their members.”

Some retirement plans are working to keep pace, however.

“We’re adding relevant features to our online capabilities,” Bishop says. “For example, members who end employment with a VRS-participating employer may apply online for a refund. Before hitting the final button to execute the request, members receive information about the impact on their future benefits and are given an opportunity to suspend the refund request at this point. This ensures members know the consequences of their action before executing the request and VRS has fully informed them. No one would have expected that level of information 10 years ago, but it’s absolutely expected now.”

But as retirement systems launch new engagement channels, they also must maintain existing contact methods. Some members will continue to communicate via phone calls and interactive voice response systems, while others choose websites and mobile apps. Making all these options available enhances customer engagement, but it also can increase personnel requirements, costs and overhead for securing member data.

In addition, as benefits become more complex, pension system administrators are realizing they need to adopt more sophisticated strategies to communicate with members.

“We have to increase our focus on targeted member communications to avoid confusion as people try to sort through all the new information,” says Vanden Bosch. “In the past we could distribute information designed for a general audience. But now we focus on customized information developed for members at critical times in their lives, so they don’t have to sort through a larger set of communications to figure out what does and doesn’t apply to them.”

4. Ineffective Legacy Technology

Because individual retirement programs have so many unique requirements, governments have relied on highly customized benefits administration software. Many of these applications are now getting old and are written in outdated programming languages that are difficult to maintain and support. These legacy technologies often support equally antiquated processes that require manual intervention by staff members.
“We see many of these administrative environments stuck with old IT systems and old processes,” says Bjørn Tore Holte, managing director at Accenture. “That is exacerbating problems in the pension area as the number of retired members is increasing. Without upgrades to technology, the only response is for administrators to hire more caseworkers, which just adds to overall costs.”

Learn how to overcome these challenges and implement pension reform in your jurisdiction by downloading the guide, “Transforming Benefits Administration: How modern technology and practices can boost plan efficiency and performance, while improving services for members and retirees” at www.governing.com/pension-administration.

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Private Sector

Growing Number of Lawsuits Claim "Old" Mortality Tables Deprive Participants of Benefits – An Update

Two plaintiffs' law firms are pressing forward with more major employers now facing challenges to the calculation of optional forms of benefits under defined benefit pension plans. The firms have now filed seven lawsuits in federal courts under the Employee Retirement Income Security Act of 1974 ("ERISA") against the pension plan sponsors—MetLife, American Airlines, PepsiCo, U.S. Bancorp, Rockwell Automation, Anheuser-Busch, and, the latest, Huntington Ingalls—as well as against the plans' fiduciaries. The lawsuits typically allege that the plans calculate the amounts of non-single life annuity forms of benefits (such as a joint-and-survivor, preretirement survivor or certain-and-life annuities) using mortality table assumptions that are not reasonable, resulting in lower benefits that what the plaintiffs are entitled to under ERISA. Plaintiffs in these lawsuits seek the difference between their plan benefits and their benefits calculated using the assumptions set by the Secretary of the Treasury pursuant to Internal Revenue Code ("Code") sections 417(e)(3) and 430(h)(3) ("Treasury Assumptions"). The aggregate amount of this difference is alleged to be in the tens of millions of dollars.

We briefly review the legal background, summarize the key arguments on both sides, offer some observations on the future of the litigation and suggest next steps for plan sponsors.

Background

Under ERISA and the Code, benefits payable to a married participant under a defined benefit pension plan generally must be paid in the form of a "joint-and-survivor annuity," which means that the participant is paid a benefit until the participant dies, and the participant's surviving spouse receives at least 50% of the participant's benefit for the remainder of the spouse's life. But pension plans typically offer optional forms of benefits such as "certain-and-life" annuities (*i.e.*, a benefit paid to a participant or beneficiary for a minimum number of years regardless of whether that person dies) or lump sums.

ERISA generally requires that all forms of benefits be no less than the amount that is "actuarially equivalent" to a single life annuity. To meet this actuarial equivalence requirement, plans use both interest rate and mortality assumptions to convert the baseline single life annuity benefit to another form of benefit. The mortality assumption at issue in these lawsuits measures the anticipated life expectancy of a participant population at a given age.

When calculating lump sum benefits, ERISA requires that pension plans use the Treasury Assumptions. The Treasury mortality tables are prescribed by regulation by the Treasury

Secretary and are required to be revised at least every 10 years to reflect "the actual experience of pension plans and projected trends in such experience."

With respect to calculation of other optional forms of benefits, however, ERISA does not prescribe particular actuarial assumptions. Instead, the plan document typically provides the interest and mortality assumptions and/or a "conversion factor"— the factor resulting from the combination of the interest and mortality assumptions— to be used to convert benefits from a single life annuity to the elected optional form. These plan-governed assumptions, which were typically developed in consultation with the plan's actuary, are used to calculate benefits such as joint-and-survivor and preretirement annuity benefits.

Plaintiffs' Claims

These plan-governed actuarial assumptions are the focus of the plaintiffs' challenges in the lawsuits. Specifically, the plaintiffs challenge the use of mortality tables that are older than the mortality tables currently prescribed by the Treasury Secretary for lump sum, etc. payouts. For example, some plans employ 1971 and 1984 mortality tables used by the insurance industry. Plaintiffs allege that these tables are "outdated" and do not reflect significant mortality improvements since the tables were developed. The result, plaintiffs argue, is that plaintiffs receive lower benefits than those to which they would be entitled if the plans used "reasonable" actuarial assumptions, *i.e.*, the Treasury Assumptions. Plaintiffs maintain that this result violates ERISA's requirements that normal retirement benefits be nonforfeitable and that optional forms of benefits be at least actuarially equivalent to a participant's single life annuity benefit. The plaintiffs seek payment of the difference between their benefits calculated using the assumptions provided under the plan versus using the assumptions prescribed under the Treasury regulations for lump sums.

Defendants' Positions

Defendants have filed motions to dismiss in four of the seven cases, and additional motions are expected in the remaining three cases. While the defendants advance many arguments, common themes, and the crux of many of the defendants' positions are that ERISA does not require any specific actuarial assumptions for the optional forms of benefits at issue in these cases, and that the Treasury regulations' "reasonableness" requirement that the plaintiffs rely on is satisfied and/or is not applicable here.

Groom's Perspective

No court has ruled on any of defendants' motions to dismiss (although the motions have been fully briefed in the American Airlines and PepsiCo cases). The two firms (Izard, Kindall & Raabe, LLP and Bailey & Glasser, LLP) have now filed cases in the Second, Fourth, Fifth, Seventh and Eighth Circuits, so any eventual circuit split would set the stage for a writ of certiorari to the United States Supreme Court. If the cases are not dismissed, expert actuarial testimony and discovery would likely be required, and likely would test the concept of

"reasonableness" of actuarial assumptions.

Possible Next Steps for Plan Sponsors
Because the plaintiffs' claims generally relate to benefits already accrued, plan sponsors are somewhat limited in actions they can take to avoid being the target of lawsuits like these. However, some sponsors have decided to analyze their risk of suit, identify possible options, and consider protective steps going forward. Sponsors should be aware that, unless structured properly, these types of reviews (and specifically the resulting findings/analyses) could later find their way into litigation. Groom's litigation and plan compliance teams are well positioned to assist plan sponsors with this analysis.

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Employers Help Workers Build Household-Emergency Funds

A growing number of employers are helping workers start emergency savings accounts, reflecting concern over the impact money problems are having on productivity levels and workers' ability to retire.

Companies including Levi Strauss & Co., SunTrust Banks Inc. and Kroger Co. are encouraging employees to fund emergency accounts, in some cases by offering them cash and other incentives. Others are diverting a portion of employees' paychecks into rainy-day funds related to their 401(k) plans.

The aim: encourage employees to get their finances in order on all fronts.

"There is a growing recognition on the part of employers that people cannot save for retirement if they don't also save for emergencies and figure out a way to pay down debt," said Ida Rademacher, executive director of the Aspen Institute's Financial Security Program.

In February, BlackRock Inc. pledged $50 million to develop programs with nonprofits, companies and academics to help workers build emergency savings. In April, a bipartisan group of U.S. senators introduced a bill to make it easier for employers to enroll workers automatically into emergency-savings accounts. (Under the legislation, employees would be able to opt out.)

The companies are responding to data that indicate American workers are financially stressed.

Employees withdraw 30 to 40 cents of every dollar that goes into a 401(k) account before retirement, often to compensate for shocks to income, according to researchers at the Federal Reserve and the Internal Revenue Service.

This leakage threatens to reduce the wealth in U.S. retirement accounts by about 25% over 30 years, according to an analysis by Boston College's Center for Retirement Research. The center

says half of U.S. households are at risk of being unable to maintain their standard of living in retirement.

Employers are also concerned about the impact of financial stress on productivity.

In a 2018 paper, researchers at the University of Pittsburgh found that truckers who reported financial worries were more distracted and had more accidents, inflating one company's total by about eight accidents a year.

Many Americans are experiencing stagnant incomes and rising costs, said Ms. Rademacher, who argues that employers should focus on improving job quality and pay, as well as on ways to make it easier for workers to save.

The need for emergency savings applies to people across the income spectrum. Expenses for households with median incomes fluctuate by nearly $1,300 a month, according to the JPMorgan Chase Institute.

The median cost of an unexpected major expense, such as home repairs or a hospitalization, was about $2,000, according to a 2015 report from Pew Charitable Trusts.

"We always knew people with minimum-wage jobs were experiencing financial stress, but the middle class is now also experiencing significant stress that wasn't there a generation ago," said Carrie Leana, a professor of organizations and management at the University of Pittsburgh and a co-author of the 2018 study.

SunTrust gives employees $1,000 if they complete an eight-part financial-education course and take certain actions, including funneling automatic contributions of at least $20 per pay period to emergency savings.

The bank has spent more than $18 million on the incentives and 18,000, or about 80%, of its employees are participating.

SunTrust offers the program at cost to 200 other companies including Home Depot Inc. One-third of the companies offer cash incentives that average $250. More than 95% of the participants who have completed the financial education course at these companies have emergency-savings accounts, up from 70% at the time of enrollment, with an average increase in balance of more than $1,200, said Brian Nelson Ford, a financial-well-being executive at SunTrust.

Andre Dyer, 50 years old, an executive recruiter at SunTrust, said his finances were precarious

until he participated in the program.

“We never had emergency cash,” said Mr. Dyer, who borrowed $4,500 from his mother in 2013 to prevent foreclosure. “We had a jar on our kitchen counter with change in it.”

Since completing the program in 2014, Mr. Dyer has contributed an average of $600 a month to an emergency fund. He and his wife have paid off $35,000 in debt since 2013, started saving for their daughters’ college educations and amassed more than $100,000 in 401(k)s.

The emergency fund “enables us to have some peace of mind,” he said.

Levi Strauss has started offering its hourly workforce up to $240 over six months for contributions to an emergency savings account through its employee assistance fund.

More than 1,300 of 4,200 eligible employees have enrolled, saving $700 on average over six months.

The match “keeps savings top of mind,” said Leigh Phillips, chief executive of Earn, the nonprofit that created the platform Levi Strauss uses.

WesBanco Inc., based in Wheeling, W.Va., recently began offering its employees the opportunity to earn points to reduce health-insurance premiums by enrolling in a program called Split to Save. Employees who sign up divide their paycheck between a checking account for daily expenses and a savings account for goals including emergencies.

So far, 13% have enrolled and are saving an average of $132 a month, said Anthony Pietranton, executive vice president of human resources.

Backed by the nonprofit America Saves, the Split to Save program has been available to employers for a year. Eight companies, including WesBanco and Kroger, are using it, said George Barany, America Saves director.

Prudential Retirement, a 401(k) record-keeper, is trying another approach.

Since 2018, it has been testing a program that allows employees at 20 companies that use Prudential as a 401(k) administrator to contribute to both a 401(k) account and, using after-tax payroll deductions, a linked emergency-savings option within the account. So far, 250 people have enrolled and are contributing an average of 1% of pay to the emergency-savings portion of the account, said Harry Dalessio, head of full service solutions at Prudential Retirement.

SHARE YOUR THOUGHTS

How much do you have set aside for emergencies? Do you think companies should help employees save for such expenses? Join the conversation below.

While that is a small fraction of the 100,000 workers who are eligible for the voluntary program, Mr. Dalessio said Prudential expects to make the program available to a few thousand more clients later this year and "supports legislative changes" to make it easier for employers to enroll employees in emergency accounts automatically.

SafetyNet, a subsidiary of Madison, Wis.-based CUNA Mutual Group, allows employees to link their bank and credit cards to its program. Known as Cookie Jar, it rounds up purchases to the next dollar and deposits the difference, paid by the employee, into a bank account.

Since the product's launch four months ago, 12 companies have joined. Each has elected to provide a matching contribution of $10 or $20 a month.

So far, 40% of eligible employees have enrolled, saving an average of $105 over four months, said Dan Murray, chief operating officer at SafetyNet.

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House Passes the Secure Act Which Moves to Senate, Would Affect 401(k) Plans in Big Ways

On Thursday, May 23, 2019, the U.S. House of Representatives passed, by a huge 417 to 3 margin, the Setting Every Community Up for Retirement Enhancement Act (the "SECURE Act"). Although the current climate in Washington is unpredictable at best and because the SECURE Act enjoys wide bipartisan support, pundits forecast that the proposal stands a good chance of passing the Senate in some form before the end of this year's legislative session. If passed, it is considered likely that President Trump will sign the legislation. Should the proposed legislation become law, it could represent the most significant pension legislation since the Pension Protection Act of 2006.

In its current form, the SECURE Act is an amalgamation of a number of pension-related proposals that have been offered on and off during the course of the past several years. In fact, the Senate presently has a similar bill before it that was introduced last year, entitled the Retirement Enhancement Securities Act ("RESA"). Many of RESA's provisions could eventually make their way into the SECURE Act, and, of course, the SECURE Act might also be significantly

modified through committee or other Congressional action before being finalized.

At present, as passed by the House, the SECURE Act contains the following major provisions that apply directly to 401(k) plans:

1. *Increase Retirement Plan Access for Smaller Employers.* The SECURE Act would make it easier for small employers to provide 401(k) retirement plans for their employees by expanding and simplifying the multiemployer plan rules. Small employers generally would be able to join together to offer 401(k) plans with less fiduciary liability concern and less cost than is presently the case. Moreover, additional tax credits would be available to small employers that offer certain plans to their employees.
2. *Increase Annuity Options Available Within Retirement Plans.* The SECURE Act would also expand the current safe harbor provision that allows 401(k) plan sponsors to select annuity providers for distribution options in the form of annuities. Currently, plan providers have a fiduciary responsibility to scrutinize annuities and their providers. The new rules would generally shift this liability onto insurers, charging them with the duty to provide employers with the appropriate products.

OBSERVATION: Although the SECURE Act provision seeks to expand the use of annuities in 401(k) plans, with the stated goal of providing increased retirement income security to retirees, critics charge that the provision could encourage insurance companies to sell annuity products to plans that may be overly complicated, not adequately communicated, or simply inappropriate for the plan's general demographic.

3. *Increase the Required Minimum Distribution Age.* Under the SECURE Act, required minimum distributions from 401(k) plans would increase from age 70 ½ to age 72. (RESA would raise the age even further, to age 75.)
4. *Tax Credit Available for Auto Enrollment Plans*. A new tax credit of $500 would be available to help encourage certain small employers to adopt an automatic enrollment feature into their 401(k) plans. This credit is intended to help offset some of the costs of operating a retirement plan – although, as a practical matter, the amount is likely too small to serve as the determining factor for whether or not to adopt a 401(k) plan.
5. *Penalty-Free Distributions for Childbirth or Adoption*. A proposed new exemption from the 10% percent penalty tax for early withdrawals from 401(k) plans would allow an aggregate amount of $5,000 to be distributed from a 401(k) plan in the event of a qualified birth or adoption, provided the distribution occurs within one year of the event.
6. *Lifetime Income Disclosure for 401(k) Plans.* The SECURE Act would require that all defined contribution plans (including 401(k) plans) send a lifetime income disclosure to participants at least once every 12 months, designed to show how much income their lump-sum balance could generate over the participant's projected retirement span.

In addition to the above, there are a number of other proposed provisions, not all of which

directly impact 401(k) plans.

Comments:

When it comes to prognostications about the chances of legislation being enacted in any particular form in today's Washington, nobody claims to have a crystal ball. Further, pensions are not exactly the hottest topic in the news today, even though intense lobbying continues unabated. As always, we will be carefully monitoring the situation and will keep you posted accordingly. Remember, specific questions about new or existing law concerning 401(k) plans should be directed to your ERISA counsel or other professional benefits advisors.

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Appellate Court Affirms Award of 401(k) Plan Benefits Under QDRO Issued After Participant's Death

A federal appellate court has upheld a trial court's determination that a deceased plan participant's former spouse is entitled to part of the participant's 401(k) plan benefit, even though the participant had remarried and the qualified domestic relations order (QDRO) assigning benefits to the former spouse was issued after the participant's death. As part of a divorce settlement, the participant had agreed to assign to the former spouse the lesser of $500,000 of his 401(k) benefits or his account balance. But the state court order (the "judgment of partition") incorporating that assignment of benefits into the divorce decree was not entered until two days after the participant died in a plane crash, and a QDRO regarding the assignment was not issued until 15 months later. In the meantime, the participant's surviving spouse filed suit in federal court, claiming that she was entitled to the participant's entire 401(k) benefit. The trial court rejected her claim, and upheld the former spouse's right to the assigned benefit. The surviving spouse appealed, arguing that the QDRO was untimely because it was not issued within the 18-month window for determining whether an order is a QDRO and was issued after the participant's death.

The Fifth Circuit Court of Appeals easily dismissed the first objection, noting that the QDRO was issued within 18 months of the judgment of partition, which the surviving spouse herself had identified as the event that should start the clock for determining any QDRO's validity. Addressing the second objection, the court noted that Congress had amended ERISA to clarify that a QDRO will not fail based solely on when it is issued. DOL regulations also clarify that QDROs may be issued after the participant's death, even if no order was issued before the participant's death. Consequently, the QDRO was enforceable. An earlier Fifth Circuit decision reaching a different result was distinguishable because the facts were so dissimilar and the case predated the clarifying changes to ERISA and the DOL regulations.

EBIA Comment: A 401(k) plan participant's death results in an automatic benefit to a surviving spouse to the extent that the participant was vested at the time of death. A post-death QDRO, then, seems to present the plan with competing claims. In the past, some courts determined that unless the plan administrator had previous notice of the order, the surviving spouse's rights vested upon the participant's death, locking out the alternate payee. In other cases, the courts determined that the post-death order was a QDRO and awarded plan benefits to the alternate payee. This issue has been resolved, however, both in the DOL's regulations and, as this case illustrates, in the courts. For more information, see EBIA's 401(k) Plans manual at Section XVII.E ("DOL Regulations on Timing and Order of QDROs").

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Top 10 Areas of Focus in DOL Investigation of Retirement Plans

The US Department of Labor (DOL) has been extremely active in recent years as the federal agency investigating and enforcing the fiduciary duties under the Employee Retirement Income Security Act of 1974, as amended (ERISA). These investigations have continued to result in findings of fiduciary breach and monetary recoveries for ERISA retirement plans.[1]

In light of this active enforcement program and the resulting recoveries, retirement plan administrators should consider a compliance self-review, including on the issues that the DOL appears to focus the most. To that end, we identify the top 10 issues of DOL focus with respect to retirement plan fiduciary compliance. This list is a reminder of the importance of a proactive self-review by plan administrators, even before the DOL initiates an investigation. Morgan Lewis can assist retirement plan administrators with such a proactive self-review.[2]

1. Terminated Vested Participants That Are Missing or Have Not Commenced Benefits at Required Beginning Date.

The DOL has put significant resources since 2015 into examinations of whether defined benefit plan administrators are adequately searching for missing participants; notifying deferred vested participants that are past the plan's "normal retirement age" to commence their payable retirement benefit; and encouraging participants (especially unresponsive participants) to commence benefits on time (namely by the plan's "required beginning date"). This is a significant focus of current DOL enforcement activities and recoveries. This area can be challenging for plan administrators because there is no directly applicable guidance on the fiduciary standards that apply in ongoing plan administration or for defined benefit plan administration, although related guidance can be instructive, such as the Department of Labor Field Assistance Bulletin 2014-01, which provides guidance on searches for missing participants in terminating defined contribution plans.

The enforcement initiative is also evolving, as we have observed more of these investigations being opened, and being opened out of more regional offices. We have also observed these investigations evolving in scope, such as into the new topic of uncashed check procedures and examinations of defined contribution plans.

2. Timeliness of Participant Contributions

The DOL has long had a focus on protecting employee contributions into both retirement plans and contributory health plans. The DOL is particularly focused on making sure these contributions go into the plan (in the first place, and on time). Participant contributions are treated as plan assets, and therefore must be deposited into the plan as of the date they can reasonably be segregated from the employer's general assets. This standard will vary from plan to plan, but DOL guidance interprets this "reasonable segregation" time as at least the 15th business day of the month following the month of withholding. Informally the DOL has stated that it expects this window to be much smaller than 15 days, such as three days. There is also a seven-day safe harbor for small plans.

Part of the DOL's focus also includes reviewing whether participant loan repayments are paid into the plan, including during times of inactive services (such as leaves of absence).

Findings of breach related to the timeliness of contributions make up a high proportion of all DOL enforcement findings (by number). In egregious cases where, for example, there is intentional theft or misuse of employee contributions, the DOL will (working with the US Department of Justice) treat the matter as a criminal investigation.

3. Required Plan Documents and Disclosures

The DOL will always evaluate a plan to confirm that there is the proper maintenance of required documents and the dissemination of required disclosures. This includes the maintenance and/or disclosure of such documents as the plan's summary plan description, participant level disclosures (i.e., the 404a-5 disclosure), the receipt of plan service provider disclosures (i.e., the 408(b)(2) disclosure) and other disclosures covered by Title I of ERISA, such as blackout notices for investment or service disruptions, and mapping notices, if the plan is seeking 404(c) protection when it changes the plan's investment options.

If the DOL finds gaps in a plan's required documents, it will typically focus on encouraging the plan administrator to fix those gaps. However, in egregious cases, the DOL may impose statutory penalties for the failure to provide such disclosures (or maintain required documents).

4. Bonding

The DOL will almost always request evidence of a plan's bond. ERISA Section 412 generally requires that every plan fiduciary and every person who handles plan assets be bonded for at least 10% of the amount of funds he or she handles, up to a maximum of $500,000 per plan ($1 million for plans that hold employer securities). The bond must protect the plan from the theft of plan assets.

In our experience, when the DOL discovers that a plan lacks a bond, it will require that a bond be obtained before closing the investigation.

5. Plan Fiduciary Processes and Claims Procedures

The DOL will often review a plan to confirm that the plan is processing claims in accordance with the DOL claims regulations (which set minimum time lines and disclosures for the processing of claims and appeals). Although this issue arises more frequently with respect to health plans, the DOL also reviews retirement plans to confirm compliance with its claims regulations. For example, the DOL routinely asks for recent claims and appeals and reviews those materials against the requirements of its claims regulations. For that reason, care should be taken to implement a program to comply with those regulations, and document such compliance, when handling participant claims and appeals.

Although not necessarily required under ERISA, the DOL will also examine whether a plan operates with certain documents and structures that it views as "best practices" to achieve compliance with ERISA's fiduciary standards. These include a plan investment policy statement, a fiduciary or trustee committee, regular committee meetings, and minutes from the plan's named fiduciary (i.e., the fiduciary committee). The DOL will often view the lack of such documents or structures as probative of an inadequate fiduciary process (even though the law may not require these documents or structures). Moreover, in cases where there are other facts establishing a possible fiduciary breach, the DOL frequently cites the lack of these documents or structures as probative of the fiduciary breach.

For that reason, although not necessarily required by law, it can be helpful for a plan to have in place these documents and structures such as an investment policy, a fiduciary committee, regular committee meetings, and well documented committee minutes.

On the other hand, to the extent a plan uses these documents, the DOL will often examine those materials carefully and treat them as definitive evidence of the plan's fiduciary actions. For example, the DOL routinely asks for and reviews all recent committee meeting minutes, and will often cite the statements in such minutes as irrefutable fact. For that reason, care

should be taken to ensure that such fiduciary documents (and especially committee meeting minutes) are up to date and accurate, and do not misrepresent any facts.

Similarly, if the plan uses an investment policy statement, the DOL will often take the position that the policy is a "plan document" and that ERISA Section 404 requires the plan's fiduciaries to follow the terms of that investment policy. Although there is disagreement with this interpretation of the law, it is generally the position taken by the DOL. Accordingly, care should be taken to keep the investment policy statement up to date and follow any such policy when investing the plan's assets.

6. Fiduciary Duties and Prohibited Transactions

In general, the DOL has been consistently focused on enforcing ERISA's core fiduciary duties and prohibited transaction rules. To that end, the DOL is always considering whether a plan has been involved in any breaches of fiduciary duty or prohibited transactions.

For example, the DOL often examines whether plan assets are being used to pay nonplan expenses, such as plan sponsor expenses, which can be a nonexempt prohibited transaction. One element of this is whether the plan can pay for the salaries of plan sponsor employees. DOL guidance permits such payments in certain circumstances (namely if the services would not have been incurred but for the plan). Where plan sponsor employees have a portion of their salaries paid out of the plan, the DOL will often examine those payments and evaluate whether they comply with that standard. A related issue is whether the plan has properly set up its program for reimbursing the sponsor for plan-related expenses. Among other things, such reimbursements should be made in accordance with a loan agreement in order to avoid a nonexempt prohibited transaction. More generally, the DOL is concerned with any type of loan from the plan that is improper. Finally, the DOL generally has a concern with unreasonable expenditure of plan expenses, such as using plan assets to pay for overly expensive conferences or other inappropriate benefits for plan fiduciaries. This is particularly a focus (and a subject of DOL scrutiny) for multiemployer plans that do not have a plan sponsor to pay expenses related to the plan.

7. Plan Investment Conflicts

A subset of the DOL's interest in ERISA's fiduciary duty standards is the agency's "Plan Investment Conflicts" national enforcement priority. The DOL describes this initiative as being focused on fiduciary service provider compensation and conflicts of interest, including fiduciary service providers and investment managers that have conflicts of interest that may lead to conflicted decision-making processes, imprudent application of investment guidelines, and payment of excessive fees. For example, the DOL is concerned with circumstances where

a fiduciary advisor selects investment options on the basis of revenue sharing or fee sharing in a manner that is not properly disclosed to the plan or otherwise violates ERISA. With respect to plan administrators, the key inquiry by the DOL will be whether the plan's fiduciaries are adequately engaging in due diligence related to such plan investments and service providers in order to identify and address these types of conflicts of interest.

The initiative also examines improper or undisclosed compensation, such as undisclosed indirect compensation. In this regard, the enforcement initiative ties in with the DOL's participant (404a-5) and plan level service provider (408(b)(2)) disclosure requirements and the agency's focus on comprehensive disclosure about service provider compensation and conflicts of interest. For example, it is routine for the DOL to request a plan's 404a-5 disclosures sent to participants and 408(b)(2) disclosures received by service providers, and to cite any gaps in the delivery or receipt of those documents.

Finally, the "Plan Investment Conflicts" initiative includes criminal investigations of potential fraud, kickback, and embezzlement involving investment managers and advisers to plans and participants. Every year, the DOL assists in many criminal investigations and prosecutions involving these types of crimes.

8. Hard-to-Value Assets

In February 2012, the US Government Accountability Office (GAO) issued a report finding that the DOL has not taken sufficient actions to regulate retirement plan investments in hedge funds and private equity funds. The report also expressed concern with the DOL's limited focus on these investments, including investment losses and other challenges such as limited liquidity and transparency. Following the GAO report, in September 2013 the DOL Office of the Inspector General (OIG) issued a similar report focused on DOL regulation of ERISA plan investments in hard-to-value assets. In particular, the report concluded that the DOL had not taken sufficient steps to regulate plan holdings of "hard-to-value" assets and that "[a]s a result, plans are using poor practices in valuing these investments." Among other things, OIG recommended that the DOL improve enforcement in this area. After issuing its report, OIG sent a number of letters to retirement plans requesting information and documents on their valuations of hard-to-value assets. The letters also seem focused on whether the plan sponsor relies on the value provided by the fund manager or whether a third-party (such as the plan's trustee or another party) independently reviews that value.

Since the GAO and OIG reports, and the OIG requests, the DOL has shown some investigatory interest in hard-to-value assets, especially in defined benefit plans. For example, document requests of defined benefit plans often ask for "documents regarding the investment of the Plan in any alternative investments, including but not limited to mortgage backed securities,

commercial paper, foreign obligations, and 'other' investments." There have also been requests for appraisals for plan investment options where "the market value . . . is not readily determinable" and information regarding off-shore investments.

Based on these requests, it seems clear that the DOL has some investigatory focus on hard-to-value assets, especially around defined benefit plans. However, thus far it does not appear that this interest has yet translated into a high quantity of investigatory findings of fiduciary breach or recoveries by the DOL. Nonetheless, plan investment fiduciaries should take care to evaluate and monitor the plan's hard-to-value assets.

9. Proprietary Funds and Services

For those plan sponsors that offer services to retirement plans, or investment funds, the DOL has conducted a number of investigations on the use of those proprietary services or proprietary investment funds. This initiative is similar to (and raises similar issues to) the private plaintiff cases that have been brought in recent years regarding proprietary services and funds. The DOL appears to have conducted a number of investigations on this issue, and appears focused on whether the services and funds were selected and retained after an adequate fiduciary process (in addition to considering proprietary fund issues) and has made adverse findings in at least some of them.

One of these investigations recently ended in a significant judgment. In April 2019, the US Court of Appeals for the Ninth Circuit upheld (in Acosta v. City National Corporation) a $7.4 million judgment that was based upon a finding of a 406(b) self-dealing prohibited transaction due to a bank using its own recordkeeping services for the retirement plan of its employees, and in so doing collecting compensation through revenue sharing.

In light of this initiative, plans that utilize proprietary funds or proprietary services consider a self-review of those investment options or services.

10. ESOPs

Employee Stock Ownership Plans (ESOPs) are defined contribution plans designed to invest primarily in the stock of the sponsoring employer. ESOPs can be standalone or components of a larger defined contribution plan.

The DOL has been very focused on investigating ESOPs since at least 2005, when it established the ESOP National Enforcement Project. In examining ESOPs, the DOL has been focused on such issues as whether the employer securities have been correctly valued (when purchased, sold, or distributed); the failure to provide participants with the specific benefits required or allowed under ESOPs, such as voting rights, participant distributions, and stock sale rights; and whether corporate governance is being passed on to participants correctly. These

investigations make up a significant portion of DOL enforcement work and recoveries. For plans that are not standalone ESOPs, the DOL's focus is still of concern if the plans maintain an ESOP component.

[1] Read our previous publications on this topic, including: April 9, 2019, February 15, 2018, January 11, 2018, January 29, 2018, and November 23, 2015.
[2] We will publish a similar list of the top 10 issues that the Internal Revenue Service is concerned with in its own audit activities.

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