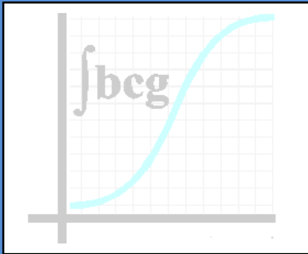

BCG Retirement News Roundup

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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

How California Public Agencies Can Reform Pension Benefits

In 2011, in a report that led to the enactment of the California Public Employee Pension Reform Act (“PEPRA”), the Little Hoover Commission gave a dire warning:

California’s pension plans are dangerously underfunded, the result of overly generous benefit promises, wishful thinking and an unwillingness to plan prudently. Unless aggressive reforms are implemented now, the problem will get far worse, forcing counties and cities to severely reduce services and lay off employees to meet pension obligations.

This warning came after the Great Recession reduced the value of the CalPERS fund by 24 percent in a single fiscal year to approximately $180 billion, leaving CalPERS 61 percent funded.

Today, after nearly a decade of market growth and increased pension contributions by both employees and employers, the situation is not fundamentally different. Despite the CalPERS fund more than doubling in size to over $370 billion, CalPERS is still only about 70 percent funded. With fears of another recession looming, public agencies need to take steps sooner rather than later to plan ahead and consider how CalPERS’s unfunded liabilities will affect them.

Although CalPERS has already taken steps to reduce its unfunded liability, much of the burden fell on employers. For example, CalPERS changed actuarial policies to shorten the period in which employers pay their unfunded liability, trading higher up-front costs for long-term savings. CalPERS has also lowered its assumed rate of investment returns – used to “discount” contributions towards future benefits – from 7.5 percent to 7 percent, meaning that agencies will have to pay higher contributions to pay for a given benefit. However, CalPERS’s own financial investment advisor has estimated that expected returns are closer to 6 percent, and if investment returns do not meet the 7 percent target, CalPERS is likely to increase contribution rates even further to make up for the shortfall. In the event of a recession, the need for additional rate hikes will only increase.

Between already-accrued pension benefits and CalPERS’s efforts to reduce unfunded liabilities, pension costs represent an increasing share of the annual budgets for many public agencies, crowding out discretionary spending and reducing the funds available for public services.

RESTRICTIONS ON ABILITY TO CONTROL RATES

Managing these increasing costs is a difficult task, due to several legal restrictions on agencies available options, including constitutional principles, statutory provisions, and the realities of labor negotiations.

Constitutional restrictions

Under California law, once a public agency makes an official declaration of policy, by express or implied contractual terms, to provide a pension or other post-employment benefits for its employees, an employee becomes “vested” in those future benefits. California courts have

generally held that contractual pension rights are vested as of each employee's first day of employment after the public agency adopts the policy; this is known as the "California Rule."
Once a benefit is determined to be a vested, it is protected by the Contracts Clauses of the United States and California Constitutions. This prohibits a public agency from revoking or adversely modifying that benefit, as that would constitute an unconstitutional impairment of a contractual obligation.

However, this does not mean that agencies are completely precluded from modifying future benefits for current employees or even for existing retirees. A thorough vesting analysis performed with the help of legal counsel may reveal several avenues for agencies to reform pension benefits.

1) Was there a valid and binding contractual promise to provide post-employment benefits?

For example, if a retirement benefit adopted by a city council resolution does not comply with procedural requirements under the city charter, or if a benefit adopted by collective bargaining is void because of a conflict with federal tax law, those promises might be unenforceable. [i]

2) What where the terms of that contractual promise?

If an employer's current policy or practice is more generous than the benefit that was actually promised, the employer may be able to revert to the benefit level that was promised.[ii] And if the terms of the alleged promise are not explicitly stated, California courts have held that employees and retirees have a heavy burden in demonstrating an implied vested right to a continued benefit.

3) Does the contractual promise permit the employer to make modifications to the benefit during or after employment?

For example, a specific benefit set forth in a negotiated memorandum of understanding may only be binding for the term of the agreement, unless it was already vested prior to inclusion in the MOU or unless the MOU contained an express or implied term indicating the parties intended the benefit to extend beyond the life of the agreement. Or if retirees were promised the same health benefits as those negotiated for current employees, the employer may well have room to negotiate lower benefits for both groups.

If a particular post-employment benefit has in fact vested, the employer may only reduce or eliminate that right in very narrow circumstances. For current retirees, a vested benefit may only be impaired upon agreement between the retiree and the public agency. For current employees, it can be impaired if the parties agree, or if the employer makes "reasonable" modifications for the purpose of maintaining the integrity of the pension system, which must be determined on a case-by-case basis.

Statutory restrictions

CalPERS pension benefits for all participating agencies are governed by the Public Employees' Retirement Law ("PERL") and by PEPRA. Before PEPRA, one tool many employers made use of was to negotiate lower benefits for future hires, while preserving benefits for existing employees and thus avoiding any impact on vested rights. However, in most cases this is no longer possible under PEPRA. PEPRA itself did impose a lower tier of benefits for "new members" (generally, those who

first became CalPERS members in or after 2013). But the law also requires that all "classic members", including lateral hires from other agencies, must receive the same benefits as if they had been hired in December 2012. Thus, in most agencies, reducing future benefits is no longer an option.

There is one limited exception: For safety members, PEPRA provides three available benefits formulas. The default formula is whichever of the three is closest to, but no more generous than, the formula provided to classic members. But PEPRA explicitly allows agencies to negotiate a lower tier of benefits for future safety hires.

Labor relations

A third restriction on agencies' ability to reduce pension costs is the obligation to notify and bargain with employee organizations under the Meyers-Milias-Brown Act ("MMBA") and other similar labor relations statutes. For obvious reasons, public employees and employee organizations are often very hesitant about changes that could potentially reduce their own future benefits or increase pension contributions and thus reduce their take-home pay.

But fundamentally, both employers and employees have an interest in resolving the pension crisis, and no one benefits by avoiding the necessary reforms. If agencies do not take steps to manage pension liabilities, the problem will only compound over time, increasing the risk of pay cuts, layoffs, or even bankruptcy. By taking a transparent and collaborative approach to labor negotiations, agencies and employees can work together to protect the public pension system.

Possible solutions

With all of these restrictions, trying to reduce increasing pension costs may seem like an impossible task. Luckily, with a good understanding of the law, a creative approach, and strong leadership agencies still have options available.

Cost sharing – Have employees shoulder more of the burden

Some provisions of PEPRA have helped reduce ongoing pension costs for employers by requiring employers to help fund their own future benefits. The law eliminated employer-paid member contributions ("EPMC") for "new" members, and required that new members pay at least 50 percent of the actuarial normal cost of their own pension benefits. For Classic members, agencies can still make the same reform by reducing or eliminating EPMC, in order to have employees bear the full cost of their own contributions.

In addition to eliminating EPMC, agencies can ask – or in some cases require – employees to help share the cost of the employer's contribution. Under Government Code section 20516.5, after negotiating in good faith and completing any applicable impasse proceedings, agencies can require employees to contribute up to 50 percent of the normal cost, so long as doing so is no more than a specified percentage of pay. Because new members already contribute at least 50 percent of the normal cost, this only applies to classic members. And because of the percentage limits, this option is also irrelevant for many non-safety classic members. The highest rate that non-sworn employees can be forced to pay is 8 percent of pay. For agencies that adopted one of the enhanced non-safety formulas for classic members (2.5% @ 55, 2.7% @ 55 or 3% @ 60), employees are already paying an 8 percent member rate. Government Code Section 20516.5 is

most applicable to Classic safety employees, because the statutory maximums are higher (12 percent for peace officers and firefighters and 11 percent for other safety members, or 50 percent of normal cost, whichever is lower).

In addition, for both classic and new members, Government Code section 20516 allows employers and employees to agree to have employees pay an even larger share of pension contributions. When negotiating cost sharing, it is important that agencies carefully calculate the cost of anything given in return. For example, employee groups may ask for a wage increase that matches the amount of the cost share, e.g. a 2% pay raise in exchange for contributing an additional 2% of pay towards pension. This is not a cost neutral exchange. Because the salary increase will also result in other costs, such as increased CalPERS contributions and overtime costs, this exchange would actually result in an increased net cost to the agency. For an exchange to be cost neutral, the negotiated cost share amount will need to account for both the direct cost of a salary increase (or anything else given in return) and any additional “roll up” costs.

Reducing reportable compensation

Another option is to negotiate changes to employees’ compensation and benefits to reduce the amount that is reportable to CalPERS (or “PERSable”). As an example: a pay raise would increase PERSable compensation and therefore also increase future pension liability and ongoing pension contributions; instead, an agency could provide increased health benefits or paid time off.

Employers can also renegotiate specialty pays so that they do purposely not satisfy the requirements of the CalPERS regulations governing reportable “special compensation,” making the pay non-reportable. For example, when a compensation item combines the requirements of two or more recognized special pays (such as longevity or performance bonuses), the result is a non-reportable “hybrid” pay.

In addition, CalPERS has indicated that when an agency makes a general salary increase to a group of employees (such as a bargaining unit covered by an MOU), any lump sum payments made in the same fiscal year are not PERSable. For new members, one-time payments are not reportable under any circumstances. For new members, uniform allowances and bonuses are also non-reportable. For this reason, agencies with a high proportion of new members should consider focusing compensation increases towards these types of pay.

Retiree medical benefits reform

Many agencies can potentially achieve significant savings by restructuring health benefit costs for current and future retirees, such as by moving retirees to more affordable plans or reducing the agency’s contributions. But agencies should be aware of legal limitations: for employers that provide healthcare benefits through CalPERS, statutory provisions in the Public Employees' Medical & Hospital Care Act (PEMHCA) set strict minimums for employer contributions. Employers should also analyze whether employees and retirees have vested rights that would impose constitutional protections on retirement benefits in their current form. Public agencies considering this option should consult with trusted legal counsel.

[i] San Diego City Firefighters, Local 145 v. Board of Admin. of the San Diego City Employees’ Retirement Sys. (2012) 206 Cal.App.4th 594 [141 Cal.Rptr.3d 860].
[ii] Retired Employees Assn. of Orange County, Inc. v. County of Orange (9th Cir. 2014) 742 F.3d 1137, 1142.

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403(b) and 457(b) Plans Going Under the Regulatory Microscope

It appears that the SEC has initiated a "sweep" examination to inquire into the sales practices applicable to retirement plans for teachers and state and local government employees. We understand that multiple SEC regional offices have issued document requests seeking information from the third-party administrators, the broker-dealers, and the registered investment advisers that work with 403(b) and 457(b) plans. Further, the New York Department of Financial Services (NYDFS) recently launched an investigation into the sales tactics and costs involved with 403(b) plans, which appears to focus on the annuity practices of the insurance industry.

Many of these 403(b) and 457(b) plans are not subject to ERISA and its higher regulatory standards (because, e.g., they are for state and local government employees, including public school teachers). Consistent with this, the potential regulatory concerns are corroborated by some comparative analyses revealing that these plans have higher-costing investments than their private sector 401(k) counterparts (and in some cases significant percentage differences) and concerns about high commissions and other sales practices.

These investigations are significant because historically regulators have not focused on this area of the financial services industry. Thus, these efforts by the SEC and NYDFS appear to be the first industry-wide foray and investigative activity into any potential abuses therein. With the SEC's Share Class Selection Disclosure Initiative and related efforts perhaps fading into the past, this may be the next focus area for SEC Chairman Jay Clayton's continuing prioritization of issues impacting "Main Street" and retirees.

These efforts appear to be related to concerns first raised in 2017 and again in summer 2019. On July 20, 2017, the SEC issued its "Investor Bulletin: Retirement Investing Through 403(b) and 457(b) Plans." On June 3, 2019, the SEC announced Enforcement and Investor Education Initiatives to Protect Teachers and Military Service Members. These initiatives are led by Enforcement's Retail Strategy Task Force in partnership with the Commission's Office of Investor Education. More recently, in October 2019 at the Securities Enforcement Forum in Washington, D.C., Chairman Jay Clayton took the opportunity to use that platform to advise that "Teachers and military folks hold a special place in all our hearts at the SEC."

For all these reasons, we should anticipate that the SEC's Division of Enforcement will pursue this particular sweep aggressively.

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Massachusetts Voters Would Support State Retirement Plan

2019 Work and Save Survey: Massachusetts Registered Voters

This AARP survey explored the opinions of 600 registered Massachusetts voters ages 25-64 on retirement saving issues. Almost one in five registered voters said that their employer does not offer a retirement savings plan. Data from this survey found strong support among Massachusetts voters for a state retirement savings program, and most agree that elected officials in the state should support legislation making it easier for workers to save for retirement.

Well over half of all registered voters say they feel anxious about having enough money to live comfortably in retirement, and most are concerned about cost of living, health care, and other expenses eating up their retirement savings. Massachusetts registered voters believe retirement savings is important, and they are concerned that some residents may have inadequate savings and could end up relying on public assistance programs. The majority of voters surveyed say that they would take advantage of a state retirement savings plan.

Interviews were conducted between May 1 and May 6, 2019. The sample was drawn from a registered voter list. Half (300) of the interviews were conducted via landline phone and half (300) were conducted via cell phone. All data are weighted by age, gender, and race/ethnicity according to the April 2019 Massachusetts voter database statistics.

2019 Work and Save Survey: Massachusetts Registered Voters:

https://www.aarp.org/content/dam/aarp/research/surveys_statistics/econ/2019/massachusetts-work-and-save-survey.doi.10.26419-2Fres.00315.001.pdf

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Public Pension Plans Continue to Shift Into U.S. Stocks

47% of plans' assets were in U.S. stocks in third quarter, the most since 2007

As the bull market enters its 11th year, state and local pension plans are piling on risk, as they try to make up shortfalls.

Public plans had a median 47.3% of their assets in U.S. equities at the end of the third quarter, according to database Wilshire Trust Universe Comparison Service. That is more than they have had since 2007 and up from 44.1% a year earlier.

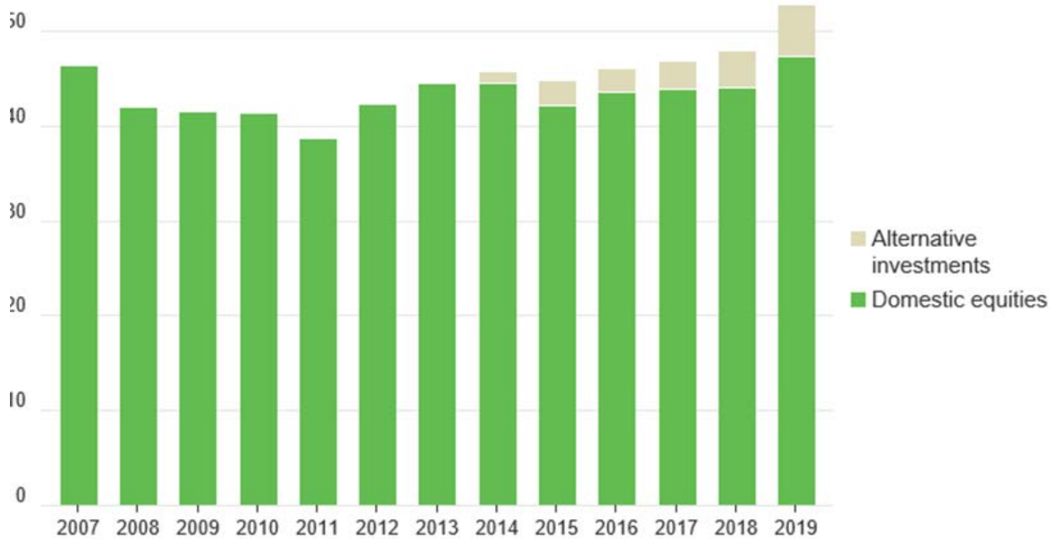
Taking on more exposure to stocks is a riskier bet, especially as global economic growth is slowing and talk of a potential recession has grown louder. Those risks can translate to consequences in a decline: Big hits to pension funds' stock portfolios during the financial crisis were followed by a wave of benefit cuts for government workers hired since then.

Retirement systems that manage money for firefighters, police officers, teachers and other public workers are banking on market returns of 7% or more to help cover shortfalls. State and local pension plans have about $4.4 trillion in assets, according to the Federal Reserve, $4.2 trillion less than the value of promised future benefits.

"They are looking for risk and finding it in the equity market, and historically they have been benefiting from that," said Robert J. Waid, managing director at Wilshire Associates. "The concern is going to be when and if that changes."

Public pensions have more of their assets in domestic equities and alternative investments than they have in more than a decade.

Share of assets, third quarter of each year.
Source: Wilshire Trust Universe Comparison Service



Many plans have also added new kinds of risk since the crisis. Alternative investments such as private equity made up a median 5.6% of public plan portfolios at the end of the third quarter, the most since Wilshire TUCS began collecting the data. Some plans have also shifted money out of more conservative investments such as bonds.

Total equity allocations, including international stocks, have risen as high as 59.4% in the past decade, according to the data, and stood at 57.4% of assets as of the end of the third quarter.

Pension-fund returns can have profound impacts on a city or state because when returns fall short, the amount the government must contribute increases, potentially diverting money from other public services.

Keith Brainard, research director of the National Association of State Retirement Administrators, said public pension funds base their decisions about how to allocate on a variety of factors including a very long-term investment horizon. As equity allocations have grown, he said, “The question in the mind of some might be, ‘Oh, shouldn’t you pare that back?’ And the response from a professional investor might be, ‘No, we’re looking at the next 20 or 30 years, and my models are telling me we should keep going with it.’”

The decadelong bull market has buoyed the holdings of public pensions, whose median returns averaged 8.57% a year for the 10 years ending in the third quarter, according to Wilshire TUCS. These retirement funds still face significant shortfalls because many pension funds have relied on overly optimistic investment-return targets that kept annual contributions low.

Meanwhile, some state and local governments facing budget pressure repeatedly decided not to make the full contributions recommended by their actuaries. Courts have also blocked some government efforts to reduce benefits for existing workers.

The $25.3 billion Teachers' Retirement System of Alabama has spent the past decade with much of its investments in the stock market. It now has on hand nearly 72% of the assets it needs to cover future benefits.

As of Sept. 30, the fund has 50.33% of holdings in its domestic equity portfolio, up from 45.9% in 2007, though the fund now groups some private investments under domestic equity that it didn't in 2007, said Chief Investment Officer Marc Green. He said cash holdings now amount to about 8%, compared with 3.5% in 2007, insulating the fund from the risk of having to liquidate stocks at unappealing prices.

"We have money sitting on the sidelines not exposed to risk assets," Mr. Green said.

Pension funds are also being somewhat more conservative than before the crisis when anticipating what they expect to earn on their investments. Major public plans projected average long-term investment returns of 7.2% a year in 2018, compared with 7.9% in 2007. If governments are able to meet their projections, public pension assets on hand will be enough to cover roughly 73% of promised future benefits, according to a study by the Center for Retirement Research at Boston College.

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Inequality and Retirement: A Conversation with Researcher Alicia Munnell

Munnell put off her own retirement to study retirement plans in America. We spoke with her about what she's learned over her career on public pensions, Social Security, and how to ensure people are able to retire with financial security.

Few people have contributed as much to our understanding of retirement in America as Alicia Munnell. Over the past two decades, the Boston College professor has helped to build a comprehensive database used by reporters at national outlets, state legislators and their staffs, retirement plan actuaries, and others. The tool has helped usher in a wave of analyses on public pension plans, but her legacy extends beyond it. She has also published a body of work on inequality in retirement as a way to draw attention to the challenges faced by older, low-income Americans. We sat down with her to talk about her career.

ARNOLD VENTURES

For years, you've been a leading voice on this wonky, complex issue. Why study retirement policy — and public pensions in particular?

ALICIA MUNNELL

After graduating from college, I moved to Washington, D.C., to work at the Brookings Institution and served as a research assistant on a book on the Social Security program. Then I went to Harvard to get a PhD and wrote my thesis on Social Security and saving. Social Security was never enough for private employees, so I started looking at private pensions. In the 1970s and '80s, I did a little bit of work on public plans. But then I moved on with my career until I started the Center

for Retirement Research at Boston College in the late ’90s and had an opportunity to go back to studying public plans because they were a neglected area of research. I started collecting data, and that’s really what brought us to where we are today.

ARNOLD VENTURES

What was the impetus for creating the Center for Retirement Research?

ALICIA MUNNELL

A Request for Proposals on retirement research came across my desk from the Social Security Administration, and I thought, “I know something about that.” I had never written a grant application before. I had this wonderful senior who was graduating. So, she and I filled out the grant application and scooped up people from MIT, the Urban Institute, and the Brookings Institution, and we won. Quite amazing.

I remember someone asking me at the time — it was a five-year grant from the Social Security Administration — won’t you run out of topics after five years? I knew that it was a field where we were just beginning to build new datasets that follow people over time, and that there were huge unanswered questions. So I was confident that it would keep me busy for at least five years. It has actually kept me busy for 20 years.

ARNOLD VENTURES

There’s certainly been a boom in research on pensions during that time, thanks in part to your work. But a lot of the information out there is conflicting. How would you characterize the financial health of these systems?

ALICIA MUNNELL

I think it’s really not useful to discuss public plans on average. Anyone who says, “All public plans are in trouble,” or, “All public plans are fine,” is wrong because they differ quite a lot. We find it very helpful to think of three groups. One is well-funded plans that are operating in a sensible fashion and have relatively high funded ratios, and that accounts for about a third. And then you have a second group — I characterize them in funded ratios, but you can characterize them in a lot of other things, too — about 60 percent to 80 percent funded. This group of plans could do better; they really need to pay their full required contribution. If they do that, they should be fine in the long run. And then we have those that are less than 60 percent funded. I would basically characterize those as basket cases where they have serious challenges. Nothing could be solved by modest changes, and really people need to sit down around a table and come to some solutions.

ARNOLD VENTURES

Researchers at the Brookings Institution recently released a report arguing that we should be looking at whether pension debt is growing faster than GDP, rather than funded ratios, to gauge how well pension plans are doing. What’s your response?

ALICIA MUNNELL

I’ve looked at the report from Louise Sheiner, and I think what she’s done is very innovative. This is an area where fresh views are very much appreciated. I don’t buy into her conclusions completely, but to think innovatively is really valuable.

I'll tell you how I think about it. In terms of public plans, I think that the sponsor should put aside an amount each year equal to the normal cost — properly calculated — of the benefits accrued that year. If you have a police officer, you should pay his wages, and you should pay the amount that's required to fund one year of pension benefits. That should be done for efficiency, so people will see the full cost of the services that they are receiving.

But that puts aside the question of unfunded liability caused by payments that were not made in the past. Our innovation is to ask how much of that cost is due to overestimating how much you're going to earn on assets — a miscalculation which you should pay off over a relatively short period of time — and how much of that is due to the initial debt burden that the plan had when it started funding. For example, Massachusetts has been promising benefits since the 1920s. The state didn't start funding its plans until 1990 — it simply paid benefits directly from its existing revenues. If I had my druthers, I would separate that unfunded liability out and pay for it as it comes due through sales tax or some type of bonding. But there's no reason to associate that with today's Massachusetts employees. The reason is not that we're putting so much aside for today's workers — because they actually pay a large part through their own contributions — but because we have a huge unfunded liability from the past. It really distorts perceptions about how expensive today's workers are.

ARNOLD VENTURES

I'm guessing a lot of these insights have come from the massive dataset, known as the Public Plans Database, which you and your colleagues have built. Could you tell me about who uses that tool?

ALICIA MUNNELL

Reporters are using it. They go there for the information, and the Public Plans Database is cited often in the "Wall Street Journal." Actuaries use it. One of them comes once a month to pull data and put their performance in perspective. People use it for academic research, and we have a lot of examples of that. We have people who are in the policy world using it. And actually people who manage public plans come to compare their funded ratios to other plans. I think we've gained a lot of credibility in terms of the accuracy of our database, and the breadth of it is increasing.

ARNOLD VENTURES

In your research, you've not only looked at systems but also at individuals. Some of your most recent studies focus on whether women and people of color, who often earn less during their careers, will have enough to retire. Tell me about that work.

ALICIA MUNNELL

We're very concerned about retirement security for low-income people, and that often is women and people of color. We generally talk about those issues through the lens of Social Security. We've put out a lot of material on financing Social Security, but we've also released some studies on how it could be modernized by taking into account the pattern of women taking time out of the labor force to care for children, and how to do something about the minimum benefit for those who have a sporadic work pattern. And we recently did some work on retirement wealth by race that noted how Social Security helps offset inequality among people entering retirement.

ARNOLD VENTURES

So, Social Security is key to addressing the ripple effects of pay gaps on retirement earnings. But since many state and local workers aren't enrolled in the program, what are the takeaways for governments?

ALICIA MUNNELL

We just did a really exhaustive study on state and local workers who are not enrolled in Social Security and the extent to which their benefits are comparable. Basically, the deal is that states and localities don't have to enroll their workers in Social Security as long as they're providing benefits of comparable value. What we found was, yes, states and localities were mostly satisfying the letter of the law in that you got sort of a comparable benefit at age 65. But if you try to look at it over people's lifetime with the inflation adjustment and everything else Social Security offers, they were falling short. There was also this issue of how do you think about beneficiaries in plans in places like Chicago, where they're actually going to run out of money. The answer here to me is very simple — you could solve the problem in a very complicated way with a lot of legal provisions, or we could just extend coverage to state and local workers.

ARNOLD VENTURES

That is a simple solution. It might be harder to implement politically, but it's simple to conceptualize. It also leads me to my last question, which is: If you were a legislator, what other things would you do to ensure people are able to retire with financial security?

ALICIA MUNNELL

In the public sector, legacy debt is very important because it clarifies the level of benefits and doesn't put an artificial burden on the current generation to pay everything off. But I would also think hard about retirement ages. In Rhode Island when then-treasurer and now Gov. Gina Raimondo was trying to reform the system, her position was that she wanted her public employees to have a secure retirement. The key question is when does that retirement start? Retirement ages in the public sector are early, and given that we're all living longer, the answer is not so much thinking about cutting the amount of the benefits, but rather to think hard about when those benefits should start. That's an issue worthy of consideration.

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Private Sector

DOL Attempts to Modernize Its Electronic Disclosure Rules with New Proposed Safe Harbor

On October 23, 2019, the Department of Labor (DOL) published a proposed rule outlining a new safe harbor for distributing certain retirement plan documents electronically. The new safe harbor adds to the current electronic disclosure safe harbor, issued way back in 2002, which is seen by

most as outdated. The new "notice and access" safe harbor, unlike the safe harbor issued in 2002, does not require affirmative consent from individuals to receive electronic disclosures and does not require an employer to determine whether individuals have work-related access to email as part of their job function.

The new safe harbor allows certain "covered documents" to be provided to "covered individuals" via posting on a website designed for the distribution of such documents, after notice of availability is given to the "covered individuals."

Who and What Does This Apply to?

"Covered individuals" generally include any participant, beneficiary, or alternate payee, regardless of employment status, who has (i) provided the employer, sponsor, or administrator with an "electronic address" (i.e., an email address or an internet-connected cell phone number), or (ii) been assigned an email address by the employer.

"Covered documents" include any document that the plan administrator is required to furnish to participants and beneficiaries under Title I of ERISA, except for documents that must be furnished upon request. Notably, the new safe harbor only applies to pension benefit plans and not to welfare benefit plans, but the DOL has indicated that welfare benefit plan rules may be addressed separately in the future.

Notice of Internet Availability

Before the safe harbor can be satisfied, a "Notice of Internet Availability" (Notice) must be furnished to individuals for each document provided under the new rule (or for a group of regular disclosures, as described further below). The Notice must be (i) furnished to the covered individual's electronic address, (ii) limited only to the content specified in the rule (employer logos and other design elements are generally ok), and (iii) calculated to be understood by the average plan participant. The Notice must contain the following information:

- A prominent statement or title that reads "Disclosure About Your Retirement Plan" along with the following statement – "Important information about your retirement plan is available as the website address below. Please review this information."
- A brief description of the document.
- The website address where the document can be located.
- A statement of the right to request paper copies, free of charge, and how to obtain such copies.
- A statement of the right to opt-out of receiving electronic disclosures, and an explanation of how to opt-out.
- A telephone number to contact the administrator (or designated representative) of the plan.

As mentioned above, certain regular disclosures may be announced via a single Notice that is provided at least once within a 14-month period. These regular disclosures include:

- Summary plan descriptions
- Summaries of material modifications

- Summary annual reports
- Annual funding notices
- 404a-5 fee disclosures
- Qualified default investment alternative notices
- Pension benefit statements required by Section 105 of ERISA

In addition to the regular "Notice of Internet Availability," the administrator is also required to provide an initial Notice in paper form that explains that some covered documents will be provided electronically along with an explanation of the rights to request a paper version and to opt-out of electronic delivery. This paper notice must be provided before the new safe harbor can be used and to each new hire.

Website Requirements

Once the Notice has been provided, the disclosures can be made via posting on a website that meets certain minimum standards. The administrator must take measures reasonably calculated to ensure that:

- The covered document is available no later than the date it is required to be furnished,
- The document remains available until it is superseded by a subsequent version,
- The covered document is searchable,
- The document is maintained in a widely available format that allows the document to be permanently retained (such as in PDF), and
- The website protects confidential information.

Odds and Ends

- The new safe harbor does not apply to welfare benefit plans, but the DOL has suggested it is considering rules for those plans as well.
- The rule would supersede the "continuous access website" rule outlined in DOL Field Assistance Bulletin 2006-03 (a separate distribution safe harbor that applies when participants have continuous access to benefit statement information via secure website) for pension benefit statements and participant-level fee disclosures.
- The rule for QDIAs that either the DOL or IRS electronic delivery rules can be relied on has been eliminated.
- The system must be designed to alert administrator of invalid or inoperable electronic address.
- Administrators are required to act when they receive notice of an invalid or inoperable electronic address for a participant and must maintain procedures designed to resolve such issues (such as sending a Notice to a secondary address).
- Administrators must take measures calculated to ensure the continued accuracy of the electronic address following a severance from employment or to obtain a new address so an individual can continue to receive disclosures after severance.

Given that the new safe harbor is optional and not mandatory, the DOL has provided that it can be relied on as of the first day of the first calendar year after it is published as a final rule in the Federal Register. Comments on the proposed rule are due November 22, 2019.

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Pension Mortality Updates May Decrease Liabilities

The Society of Actuaries' (SOA) new Scale MP-2019 mortality improvement rates will lead to lower liabilities compared to the previous versions. Along with the improvement scale, the SOA's Retirement Plans Experience Committee (RPEC) also released a set of new mortality tables, Pri-2012, both on October 23rd. The new tables and improvement scale may be used for financial reporting purposes now. The improvement scale is expected to be used in 2021 for PBGC, lump sum, and cash funding calculations.

Pri-2012 Mortality Tables

The Pri-2012 tables are the most recent private mortality tables released by the SOA since the RP-2006 tables. The SOA estimates that most plan liabilities will fall within 1.0% (up or down) of the liability they would have seen under the RP-2006 tables. The new tables were developed using data from 2010-2014 and reflect the RPEC's commitment to update the base mortality tables every five years.

When compared to the RP-2006 tables, life expectancy for a 65 year old female remains at 87.4, while the life expectancy of a 65 year old male decreased from 85.0 to 84.7.

The new Pri-2012 tables are based on more multiemployer data compared to the prior tables. Mortality experience under multiemployer plans did not differ significantly from experience in single employer plans. The SOA determined that job classification (blue-collar and white-collar) is an increasing forecaster of mortality and more indicative of future experience than benefit amount.

The SOA identified that surviving beneficiaries had higher mortality than the general population and created separate mortality tables for this demographic with the Pri-2012 tables update.

MP-2019 Mortality Improvement Scale

The new mortality improvement scale MP-2019 is based on historical U.S. population mortality. This continues to fulfill the RPEC's pledge to update the improvement scales annually.

Consistent with all prior updates since the first table (MP-2014) was released, the MP-2019 improvement scale will reduce liabilities for pension plans compared to the MP-2018 improvement scale. The SOA estimated that pension obligations will typically be 0.3% to 1.0% lower when compared to using Scale MP-2018.

According to the study, the observed age-adjusted mortality rate increased slightly from the prior year, yet it is fairly level relative to the last several years. Also, the age-adjusted mortality improvement rate averaged just 0.3% per year from 2010 to 2017, compared to 0.5% that was observed in the prior study from 2009 to 2016.

Implications for Pension Plans

Pri-2012 may be adopted for financial accounting disclosures and pension expense purposes. The adoption of the new tables will likely result in little change to liabilities. We expect plan sponsors will generally adopt the Pri-2012 tables to replace the RP-2006 tables.

Plan sponsors who have updated their improvement scale annually will generally adopt the MP-2019 improvement scale. As noted, it is expected to lower liabilities, and thus will result in lower pension expense.

We do not expect that the minimum funding calculations, PBGC premiums, and lump sum calculations will use the Pri-2012 table in the near future. However, the 2021 plan year will likely incorporate the MP-2019 scale based on the currently proposed intent from the IRS. Absent any other changes, this update will result in lower funding liability, PBGC liability and lump sum amounts for pension plans in that plan year.

More information regarding the Pri-2012 mortality table and the Scale MP-2019 mortality improvement scale release can be found on the Society of Actuaries' website links above.

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IRS Proposed New Life Expectancy Tables for RMDs

The IRS has issued new proposed life expectancy tables for calculating required minimum distributions (RMDs) from IRAs and employer plans. This has been a long time coming as the tables currently in use were issued back in 2002. The new tables account for increased life expectancy and should result in lower RMDs for most IRA owners and beneficiaries.

The new tables are currently only proposed, and a hearings and comment period has been scheduled before they can be finalized. If all goes as planned, they would be used for calculating 2021 RMDs. RMDs for 2020 are not affected and cannot be calculated using the new tables. Here are some takeaways on the new tables:

- The new tables account for people living longer and include older account owners. While the current tables stop at age 115+, the new ones include retirement account owners up to age 120+. Good news for those IRA owners who are age 119 who will be able to take slightly smaller RMDs!
- The new factor for age 70 is 29.1 and the new factor for age 71 is 28.2. These will be the factors that many IRA owner will use to calculate their first RMDs. This is an increase from the current factors of 27.4 and 26.5, respectively. These new higher factors mean that IRA owners will be taking less each year as RMDs, allowing more tax-deferred growth over the years and resulting in more retirement savings.
- There is a transition rule for those beneficiaries using non-recalculated single life expectancies to calculate RMD from inherited IRAs. They will be allowed to switch to the new life expectancy tables.
- Those taking substantially equal periodic payments [72(t) payments] using the current life expectancy tables will also be allowed to switch to the new tables without concern of modifying the current payment plan.

Keep tuning in to the Slott Report for the latest developments on the new proposed life expectancy tables! To see the new tables and related IRS guidance, please see the following link:

https://www.federalregister.gov/documents/2019/11/08/2019-24065/updated-life-expectancy-and-distribution-period-tables-used-for-purposes-of-determining-minimum

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FLASHPOINT: IRS Announces 2020 Cost Of Living Adjustments to Various Retirement Plan Limits (And Some Comments On The Hardship Regulations)

The IRS just released the cost of living adjustments for various retirement plan limitations that will take effect on January 1, 2020. Many of the limits will be increasing for 2020. The key limits that increased (shown below in ***bold italics***) include the compensation that is taken into account for plan purposes, the salary deferral limit, and the total amount that can be contributed on behalf of any participant in a defined contribution (including 401(k)) plan. The 2020 and prior year limits are as follows:

	For Calendar Year	
	2019	**2020**
Maximum Defined Benefit Plan Benefit (IRC §415(b)) *(applies to limitation years ending in indicated year)*	$225,000	***$230,000***
Maximum Defined Contribution Annual Addition (IRC §415(c)) *(applies to limitation years ending in indicated year)*	$56,000	***$57,000***
Salary Deferral Limit (IRC §402(g))	$19,000	***$19,500***
Catch-up Limit for 401(k), 403(b), 457 plans *(applies to calendar year)*	$6,000	***$6,500***
HCE Compensation *(applies to lookback years in indicated year)*	$125,000	***$130,000***
Maximum Compensation for Retirement Plan Purposes (IRC §401(a)(17)) *(applies to plan years beginning in indicated year)*	$280,000	***$285,000***
Key Employee: Officer	$180,000	***$185,000***
Key Employee: 1% Owner	$150,000	$150,000
Social Security Taxable Wage Base for OASDI Contributions	$132,900	***$137,700***
457(b) Contribution Limit	$19,000	***$19,500***
SIMPLE Salary Deferral Limit	$13,000	***$13,500***
SIMPLE Catch-up Limit	$3,000	$3,000
IRA Contribution Limit	$6,000	$6,000
SEP Threshold	$600	$600

ESOP: 5-year Distribution Factor	$225,000	***$230,000***
ESOP: Account Balance	$1,130,000	***$1,150,000***
Premiums for QLACs	$130,000	***$135,000***

The Skinny on the Hardship Regulations

We know you have received about a gazillion newsletters about the new hardship regulations. We thought we would wait until the smoke cleared to send you our quick summation of what you need to know:

1. **Deferral suspensions:** No plan can require a participant to suspend deferrals due to a hardship distribution that is taken on or after January 1, 2020. You can get rid of the deferral suspension requirement before then. The plan can get rid of the suspension for all participants affected at the time (even if their hardship distributions were taken earlier), or can limit the relief to those who take hardships after the effective date of the change. All plans with hardship distributions must be amended, either in relation to an earlier change or to eliminate the deferral suspension as of January 1, 2020.
   This is really important! Based on recent Treasury comments at a conference, if the 401(k) plan is a preapproved document, the current deadline for this amendment is the tax return due date (including extensions taken) for the employer's tax year that includes January 1, 2020. This means that, for a C Corporation that files its income taxes on a calendar year basis, the plan amendment is due by April 15, 2021, unless the return is extended. However, for a partnership with a fiscal year ending January 31, the deadline is April 15, 2020. This is right around the corner! ASPPA has filed a comment letter with the IRS asking for a fixed date. News at 11.

   Individually designed documents must be amended by the end of the second year following the appearance of this issue on the Required Amendments List—likely to happen at the end of 2019, so by December 31, 2021.
2. **All money sources available for hardship.** Plans may permit hardship distributions from earnings, QNECs, QMACs, and safe harbor contribution sources. No need to keep track of historic deferrals. Plans can continue to be restrictive if they want. Amendment needed (see above).
   403(b) plans: be careful. 403(b) plans cannot distribute earnings, and 403(b) plans funded through custodial accounts holding mutual funds cannot distribute employer contributions.
3. **"I've got no other way to pay for this."** To demonstrate that the hardship withdrawal is necessary, every requesting participant must represent in writing that he/she does not have cash or other liquid assets to satisfy the need. The employer may rely on this to grant the hardship (subject to the other requirements) unless he/she has actual knowledge to the contrary. So, an employer that really knows the participant has other liquid assets must deny the hardship, unless the employee can explain why those assets are otherwise unavailable.

4. **No need to borrow first.** A participant still must first take all available nonhardship distributions from qualified and nonqualified plans; he/she does not need to take any available loans.
5. **Casualty vs. disaster hardship.** The new regulations modify the casualty loss rules and deem federal disasters to be hardship events. Amendment needed (see above).
    1. *Casualty loss:* The availability of a hardship distribution due to a home casualty loss has always been tied to the Tax Code section allowing tax deduction of those losses. The Tax Cut and Jobs Act changed that section so that these losses are deductible only if the casualty was due to a FEMA-declared disaster. The new regulations decouple the hardship rules from that requirement, so participants can take a hardship distribution for a home loss unrelated to a national disaster.
    2. *Disaster hardship:* Historically, the IRS has issued guidance after nationally declared disasters permitting hardship distributions for expenses related to those disasters. No longer! The new regulations add a deemed hardship event for FEMA-declared disasters. Participants with principal residences or places of employment in the disaster area can take hardship distributions for any expenses or losses related to the disaster, including losses of personal property or income.

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What Employee Benefits Professionals Will Be Watching in 2020

As we look forward to 2020, we bring you a few key takeaways on the hot topics and trends that individuals operating in the employee benefits space are watching in health and welfare, plan sponsor considerations, executive compensation, fiduciary, and fringe benefits.

Health and Welfare Preventive Care Services. Section 223 of the Internal Revenue Code permits eligible individuals who are covered under a high-deductible health plan (HDHP) to establish a health savings account (HSA) to help with out-of-pocket costs associated with the HDHP. An HDHP can offer preventive care services at no cost-sharing to participants and individuals will still maintain HSA eligibility. The IRS has provided a safe harbor definition on what preventive care services are: generally, services that don’t treat any ongoing medical conditions. The latest IRS guidance, Notice 2019-45, tries to make HDHPs more appealing by expanding the definition of preventive care services.

Protecting Against Identity Theft in Taxes. In an effort to reduce taxpayer identity theft, the IRS has released new guidance that allows an employer to voluntarily include truncated taxpayer identification numbers (TTINs) on W-2s and certain other documents. This 2019 regulation finalizes rules proposed in 2017 that extend the use of TTINs beyond certain information returns, a practice allowed since 2014. This voluntary rule applies only to employee copies and employee TINs: an employer cannot truncate the TIN on copies of W-2s or other statements that go to the IRS or the Social Security Administration, and an employer can never truncate its own TIN.

Rehabilitation for Multiemployer Pension Act. A recently proposed bill, the Butch Lewis Act, would establish the Pension Rehabilitation Administration within the US Department of the Treasury and a related trust fund. The purpose of the law is to allow Treasury to make loans to

certain multiemployer defined benefit pension plans that are in critical status or insolvent through bonds without a further appropriation. While the House of Representatives passed the bill, the Senate introduced a competing bill that may negatively impact the ability of the Butch Lewis Act to get passed.

SECURE Act on Multiple Employer Plans. The Setting Every Community Up for Retirement Enhancement Act of 2019 (SECURE Act) was approved by the House of Representatives on May 23, but has yet to be approved by the Senate. It contains several significant provisions relating to tax-qualified retirement plans, including a provision that would allow for "open" multiple employer plans (MEPs) (i.e., MEPs co-sponsored by unrelated employers with no "commonality," as otherwise required by Department of Labor advisory opinions). The SECURE Act would also provide relief from the "one bad apple" rule currently applicable to MEPs, making it so that operational failures by one participating employer would not disqualify the MEP as a whole.

Part-Timers and 401k Plans. The SECURE Act would add a provision to allow part-time workers who worked at least 500 hours (as opposed to the current 1,000 hours) in three consecutive 12-month periods to make deferrals into a 401k plan. However, employers would not be required to make any employer contributions on their behalf.

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