

Developments

Recent Developments in Employee Benefits

ERISA: A 40-Plus Year Retrospective

By Ken Hohman, FSA, EA, FCA, MAAA

Forty years.

It seems like only yesterday (or possibly several yesterdays) since the Employee Retirement Income Security Act of 1974 (ERISA), was passed by the House of Representatives on February 28, 1974, followed quickly by the Senate version, which passed on March 4. After conference committee, the unified version cleared both Houses on August 22. It was signed into law on September 2, 1974, by President Gerald Ford and generally became effective January 1, 1976.

... over 160 legislative acts have amended this landmark law or the related provisions in the Internal Revenue Code ...

I started working as an actuary (actually, an actuarial technician taking actuarial exams) in May 1976, (at a \$11,400 salary, of which I was very proud). For over 40 years, I've been dispensing retirement actuarial advice. Clearly much has changed in the interim—salaries have escalated (who knew that my pay would double in a mere 40 years? 😊), as well as the commensurate cost of goods and services, and technology has exploded.

ERISA has also changed; over 160 legislative acts have amended this landmark law or the related provisions in the Internal Revenue Code (so if you ever wonder what your pension actuary or ERISA attorney do in their spare time—they are probably reading some new law or associated regulation). I will caveat here that this retrospective will be restricted to the provisions of ERISA dealing with qualified retirement plans since that is all I am reasonably competent to discuss intelligently.

Legislative background

My actuarial mentors were not enamored with ERISA—they attacked me, the fresh-faced neophyte, as if I were

somehow responsible, disdainfully grouching that I now knew as much about pension funding requirements as they did, even though they had been doing pension actuarial work long enough for it to have grayed their hair. I claimed innocence—after all, I was 22 years old and incapable of having shepherded a massive piece of legislation through Congress two years earlier. Once rational thought returned, they shared with me what they believed had precipitated such legislative overkill.

First, there was the December 20, 1963, closure of the Studebaker Automobile Company's South Bend, Indiana plant. Not only was Studebaker financially insolvent, so was its pension plan. (I made clear to my new colleagues that I may have ridden in a Studebaker, but had not been old enough to drive one, so I could not be responsible for this either.) While participants over the age of 60 retained their full pension benefit, retirement benefits were either slashed or eliminated for nearly 7,000 of the manufacturer's employees. The demise of such a high-profile company and the devastating impact on the employees caught the attention of the media, the public, and, of course, members of Congress.

... it was an NBC news program titled, "Pensions: The Broken Promise" that aired nine years after the South Bend closure that provided the catalyst for the passage of ERISA.

Also in this issue:

Developments Delivery Options: The Choice Is Yours	2
Legislation that Significantly Changed ERISA's Retirement Provisions	5
Findley Davies + BPS&M = Expanded Services	6
BPS&M Pension Liability Index	6

But it was an NBC news program titled, “Pensions: The Broken Promise” that aired nine years after the South Bend closure that provided the catalyst for the passage of ERISA. NBC news correspondent, Edwin Newman, presented a compelling (if one-sided) case for government intervention in a badly damaged pension system. (In doing my research for this article, I again watched this program, and while many of the concerns expressed have been addressed by ERISA, some multiemployer plan participants may feel “The Broken Promise” is still applicable to them.)

What did ERISA do (and not do)?

The massive Act accomplished a number of objectives. It:

- Settled jurisdictional disputes between the Internal Revenue Service and the Department of Labor
- Created the Pension Benefit Guaranty Corporation
- Established fiduciary responsibility for named individuals/groups that exercise control over a plan
- Crafted judicial processes for breaches of that fiduciary responsibility
- Initiated a number of new compliance standards related to vesting, plan funding, reporting and disclosure, and spousal benefits

What it did not do was anticipate that employers would tire of accepting the risk related to the pension promise and the subsequent transformational shift from traditional defined benefit plans to defined contribution plans. And it certainly did not anticipate the advent of 401(k) plans (which evolved in the early 1980s).

There are many who believe that ERISA is the primary cause of the slow demise of the traditional pension plan.

Certainly, ERISA imposed significantly greater requirements on employers that sponsored any qualified retirement plan, particularly defined benefit plans.

Certainly, ERISA imposed significantly greater requirements on employers that sponsored any qualified retirement plan, particularly defined benefit plans. There have been, however, a number of other factors, including the introduction of pension disclosures for corporate financial statements on a market liability basis and a shift in corporate focus from long-term growth to quarterly earnings.

If I knew then what I know now

With that backdrop—knowing what I know now—I sometimes wonder what I would do differently if I could jump in a DeLorean¹ and go back to the late ‘70s. How would my consulting advice have changed?

I have long espoused that the real difference between traditional defined benefit plans and defined contribution plans is in the allocation of retirement risks. In the traditional defined benefit environment, the

Developments Delivery Options: The Choice Is Yours

Developments is moving to electronic distribution.

This year, we plan to move away from print and publish our *Developments* and *Alerts* online.

To receive the same great articles, just faster, please choose Option A or B. If you no longer wish to receive *Developments*, select option C. **Tell us how you want to receive *Developments* by sending an email to developments@bpsm.com and entering your choice: Option A, B, or C in the subject line.**

A

Your Options:

Opt in

Opt in to our online newsletter by emailing us at developments@bpsm.com. You will no longer receive a printed copy.

B

Opt in

Receive a printed copy for now plus an online subscription by emailing us at developments@bpsm.com.

C

Opt out

Opt out of receiving print and online issues by emailing us at developments@bpsm.com.

employer assumes nearly all the risk, whereas the employee assumes nearly all the risk in the defined contribution world. In retrospect, we should have recognized that placing all of the risk on only one party is not sustainable.

In retrospect, we should have recognized that placing all of the risk on only one party is not sustainable.

With this knowledge, I would have suggested different defined benefit plan designs other than the traditional, final average earnings formula (i.e., where the pension benefit is defined in terms of the participant's average earnings over their last few years of work). This could be as simple as maintaining the final average formula but at a lower benefit level and adding a complementary 401(k) plan. This would share risks across the two plans.

I might also propose going to a career average pension formula where the benefit is based on the participant's pay throughout his or her period of employment with the employer. A final average earnings formula requires the employer to assume the inflation risk during employment. The career average formula transfers this risk to the employee, but the employer can periodically update benefits to account for inflation if the plan is sufficiently funded. These design revisions would go far to improve a retirement program's sustainability.

A cash balance plan design is another form of a career average formula, and, in today's 401(k) plan environment, it has the benefit of looking like a defined contribution plan. However, in my admittedly old-fashioned way of thinking, I prefer stating a pension benefit in terms of a lifetime income related to pay rather than as a savings account that encourages withdrawal in a single sum.

I would return to the past with a better understanding of investment risks and the interplay of the actuarial assumptions used to determine plan funding.

I was raised on Modern Portfolio Theory as the basis for pension plan investing. Simply stated, we wanted to maximize investment returns within reasonable risk tolerances. The conventional wisdom at the time was that both the employer and the pension plan were long-term entities that could withstand short-term investment losses. This approach is still followed widely and makes a great deal of sense as long as the plan sponsor understands the risks that go with it.

In the early 1980s, the Financial Accounting Standards Board introduced new disclosures for the financial statements of defined benefit plan sponsors. Previously disclosures were related to actual funding, which was based on the assumed long-term rate of return on plan assets. FASB separated accounting disclosures from funding and based the accounting disclosures on current market interest rates. It didn't take long for Congress to integrate current market interest rates into the determination of minimum funding requirements for defined benefit plans. The advent of requiring assumptions based on current conditions rather than long-term expectations introduced a counter-cyclical element in pension funding. That is, downturns in the economy, and, therefore, in investment markets (as we saw in 2000 and 2008), will require employers to contribute substantially more to their pension plans at a time when they can least afford it.

The advent of requiring assumptions based on current conditions rather than long-term expectations introduced a counter-cyclical element in pension funding.

With this history lesson under my belt, I would have suggested my clients consider more conservative investments, perhaps even high-quality bonds that match the duration of the pension plan's liabilities (what has become known as "liability-driven investing"). At a minimum, I would have helped my defined benefit clients better appreciate the risks related to volatile investment returns and the risk that the bull market of the 1980s and '90s would not last forever (contrary to the conventional wisdom of that time).

Similarly, we have a much better understanding of the impact of future mortality improvements on pension liabilities than we had 30–40 years ago. Equally important, we now have the computing capabilities to recognize these future improvements in our funding models (so, I would need to take a good actuarial programmer with me in my time machine).

At the outset, 401(k) plans were intended to be a supplementary retirement plan, but we know now that they have become the sole retirement vehicle for a large number of U.S. workers. Because these plans were developed as capital accumulation plans that would be distributed in a single sum upon retirement (or earlier

due to termination of employment), it has exposed the typical employee to significant risks that are the responsibility of the employer in the defined benefit world. Primary among these risks are investment risk and longevity risk. Employers could assume these risks, or at a minimum, play a more active role in educating their employees about the risks.

Of course, many of the changes I would recommend would not have been accommodated by the laws in place 40 years ago, but I am certain Congress would have gladly accepted the insightful suggestions being offered by a time-traveler from the future.

But let's get real

Unhappily, I do not own a DeLorean, and the state of retirement law and practice has progressed without the benefit of my 20-20 hindsight. ERISA and the Internal Revenue Code have changed greatly in the last decade, particularly with regard to pension funding requirements. And now I look disdainfully at my youthful colleagues and blame them for changes that have allowed them to know as much about pension actuarial work as someone forty years their senior.

While I get little comfort from knowing that I have lived through a four-decade cycle, I do try to fight the inclination of my generation to march around with my "The END is Near!" sign. ERISA was a game changer, and the game continues to change.

My primary complaint is that the changes have been reactive rather than proactive. Congress responds to the current crisis rather than developing a long-term plan of attack.

Clearly changes were needed. My primary complaint is that the changes have been reactive rather than proactive. Congress responds to the current crisis rather than developing a long-term plan of attack. (I have heard it said that most people make changes, not because they see the light but because they feel the heat, and this is an apt description of our legislative process).

In perspective

We need a vision of what retirement should look like over the next forty years and develop legislation to cultivate that vision. I would lobby for a goal of equitable risk-sharing between employees, employers, and the government², but I will entrust future retirement policy to the next generation—who presumably have a better handle on what millennials want from retirement. This is a body of knowledge I have not acquired over the past forty years.

¹ For those of you born after 1980, the DeLorean automobile is the preferred mode of time travel for those born before 1980.

² See Matt Klein's article on Variable Annuity Plans at <http://www.findleydavies.com/variable-benefit-plans>

Kenneth F. Hohman, FSA, EA, FCA, MAAA

Ken has spent 40 years in the retirement industry, 38 as an actuarial consultant with BPS&M. His expertise is in the design, funding, administration, and regulatory compliance of qualified and nonqualified retirement plans. His clients comprise a variety of employers, including Native American tribes, governmental entities, not-for-profit, and for-profit private employers. He established the firm's ESOP Practice Group and has extensive experience in assessing the feasibility of establishing ESOPs, including repurchase liability studies. He has presented at the annual Enrolled Actuaries Meeting on various employee benefits issues, has written articles on retirement plan topics, and has spoken at various venues, including IRS internal training seminars. Ken is a past president of the American Academy of Actuaries. He is a managing consultant in our Louisville, KY office.

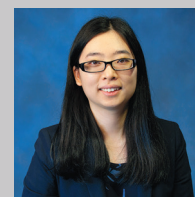


CONSULTANTS in the LIMELIGHT

On April 26, 2017, **Lauren Chrisman** and **Qin Zhou**, both of BPS&M Nashville, will copresent "Becoming an Actuary" to students seeking a Masters degree in actuarial science from Middle Tennessee State University.



Lauren Chrisman



Qin Zhou

Legislation that Significantly Changed ERISA's Retirement Provisions

Employee Retirement Income Security Act of 1974

(ERISA) – strengthened DB funding, increased reporting requirements, and established the PBGC.

Tax Reduction Act of 1975 (TRA '75) – created Tax Reduction Act ESOPs (TRASOPs).

The Revenue Act of 1978 – established 401(k) plans and SEPs.

Multiemployer Pension Plan Amendments Act of 1980

(MPPAA) – added PBGC coverage and withdrawal liability provisions for multiemployer plans.

The Economic Recovery Tax Act of 1981 (ERTA) – increased deduction limits for contributions to plans (in particular, ESOPs).

Tax Equity and Fiscal Responsibility Act of 1982 (TEFRA)

– severely reduced contributions to, and benefits from, qualified plans (i.e., Code §415 limits), and added top-heavy requirements for plans.

Deficit Reduction Act of 1984 (DEFRA) – added nondiscrimination testing for 401(k) plans, further restricted Code §415 limits, and encouraged formation of ESOPs.

Retirement Equity Act of 1984 (REA) – expanded and strengthened spousal benefit requirements.

Consolidated Omnibus Budget Reconciliation Act of 1985

(COBRA) – reduced PBGC coverage and raised PBGC premiums.

Tax Reform Act of 1986 (TRA '86) – sweeping tax law changes including increased nondiscrimination provisions (limit on pay considered in plan, added nondiscrimination tests, introduced definition of highly compensated employee, and restricted contributions to 401(k) plans and DC plans in general).

Omnibus Budget Reconciliation Act of 1986 (OBRA '86) – prohibited the reduction or discontinuation of benefit accruals or continued allocations due to attainment of a specified age and eliminated the exclusion of employees hired within five years of normal retirement.

Omnibus Budget Reconciliation Act of 1987 (OBRA '87) – strengthened funding requirements for poorly funded DB plans while restricting funding for well-funded plans and introduced PBGC variable premiums.

Technical and Miscellaneous Revenue Act of 1988

(TAMRA) – increased the excise tax on excess DB assets and generally made substantive corrections to TRA '86.

Omnibus Budget Reconciliation Act of 1989 (OBRA '89) – reduced tax benefit for ESOPs and mandated penalties for fiduciary violations (best known for repeal of Code §89).

Omnibus Budget Reconciliation Act of 1990 (OBRA '90) – increased the excise tax on DB plan reversions.

Unemployment Compensation Amendments of 1992 – added direct rollovers and 20% mandatory withholding on lump sum distributions.

Uniformed Services Employment and Reemployment Rights Act of 1994 (USERRA) – provided certain pension protections for military leave.

Uruguay Round Agreements Act of 1994 – augmented the General Agreement on Tariffs and Trade (GATT), which strengthened funding for underfunded plans and mandated additional reporting to the PBGC.

Small Business Job Protection Act of 1996 – allowed S corporation ESOPs, repealed the ESOP interest tax exclusion, created a new nondiscrimination safe harbor for 401(k) plans, and repealed combined DB-DC limits (Code §415(c)).

Tax Relief Act of 1997 – made S corporation ESOPs practical by removing the unrelated business income tax and the requirement to distribute shares to participants.

Economic Growth and Tax Relief Reconciliation Act of 2001 (EGTRAA) – increased 401(k) deferral limits and added catch-up contributions, increased Code §415 limits and the compensation limit.

Job Creation and Worker Assistance Act of 2002 – provided DB funding relief and contained numerous clarifications and technical corrections.

American Jobs Creation Act of 2004 – expanded the viability of S corporation ESOPs and added Code §409A relating to nonqualified deferred compensation.

Pension Protection Act of 2006 (PPA) – dramatically changed and strengthened DB funding requirements, added an Annual Funding Notice, increased PBGC premiums, increased deduction limits for DB plans, and provided an auto-enrollment safe harbor for 401(k) plans.

Worker, Retiree, and Employer Recovery Act of 2008 (WRERA) – provided DB funding relief as a result of the 2007-08 financial crisis.

Preservation of Access to Care for Medicare Beneficiaries and Pension Relief Act of 2010 – provided additional short-term DB funding relief.

Moving Ahead for Progress in the 21st Century Act of 2012 (MAP-21) – provided additional DB funding relief and increased PBGC premium rates.

Highway and Transportation Funding Act of 2014 (HATFA) – provided additional DB funding relief.

Multiemployer Pension Reform Act of 2014 (MEPRA) – allowed benefit suspensions for multiemployer plans in critical and declining status.

Bipartisan Budget Act of 2015 (BBA '15) – provided additional DB funding relief and increased PBGC premium rates.

Findley Davies + BPS&M = Expanded Services

On September 30, 2016, BPS&M left the Wells Fargo fold and joined Findley Davies. If you're worried this will change the valuable, long-term relationship you have had with BPS&M, don't be.

More services

As an independent consulting firm, the newly combined Findley Davies|BPS&M can offer our clients a breadth and depth of consulting services equal to those provided by much larger HR consulting organizations.

In addition to the full array of defined benefit, defined contribution, and retiree health care consulting services offered by BPS&M in the past, Findley Davies|BPS&M is well positioned to meet your many other HR consulting needs. Our benefit and HR services include actuarial and retirement, health and group benefits, wellness programs, human capital management, HR effectiveness and technology solutions, change management and communication, mergers and acquisitions, technical and

research services, ESOP consulting, and organizational development, including focus groups, compression planning, and culture surveys.

Greater depth

The combined Findley Davies|BPS&M organization not only offers an array of comprehensive consulting services, it also provides a deeper bench. With 200-plus employees, more than 2,000 clients throughout the U.S., and our knowledge base concentrated in seven offices, consultants easily share their experiences and expertise and draw on a depth of knowledge and recognized thought leadership gained through years of working with clients from all industries.

If you would like more information about our combined Findley Davies|BPS&M services, visit findleydavies.com.



The BPS&M Pension Liability Index

Updated as of January 31, 2017

By Jeffrey Thornton, FSA, EA, MAAA

Interest rates are arguably the primary driver of the volatility in pension plan liabilities. BPS&M has established a set of liabilities and applied the yield curves to those liabilities in order to create the indices used to demonstrate the effect of interest rates on plan liabilities. The BPS&M Pension Liability Index tracks the percentage change in liabilities for a typical defined benefit plan under the following four interest rate standards, which are in general use:

1. The Full Yield Curve published by the IRS for minimum funding purposes under IRS Code §430.
2. The 24-month Averaged Yield Curve published by the IRS for minimum funding purposes under IRS Code §430.
3. The Adjusted Average Yield Curve reflects the impact of the Moving Ahead for Progress in the 21st Century Act (MAP-21), the Highway and Transportation Funding Act of 2014 (HATFA) (see BPS&M *Alerts* dated September 16, 2014), and the [Bipartisan Budget Act of 2015](#) (BBA 2015). HATFA and BBA 2015 extended the

funding relief, which was introduced by MAP-21 in 2012. Originally, under MAP-21, the funding relief began to diminish in 2013, but has been extended under BBA 2015, such that it now does not begin to diminish until 2021.

4. A Corporate Financial Yield Curve used for financial statement pension liability determinations. Prior to January 1, 2014, this was measured using the Citigroup Pension Discount Curve. As of January 1, 2014, this is measured using the BPS&M Pension Discount Curve (AA-rated or higher).

The BPS&M Pension Liability Index uses a hypothetical plan for benchmarking purposes based on "typical" pension plan features. The duration of the liabilities under this hypothetical plan is 15 years. The benchmark period for the Index starts with the effective date of the Pension Protection Act (January 2008), and the graph shows the rise and fall in liabilities due to changes in interest rates relative to that date. All other

factors remain constant throughout the benchmarking period; ergo, the change in liabilities is due solely to the interest rate environment.

The trends demonstrated in the graph will generally hold true for most pension plans, but the magnitude of the percentage changes will vary depending on a given plan's demographics and benefit accrual patterns.

The table shows the percentage changes in the indices over various periods.

Indices Changes			
Indices	Since Inception (1/1/08)	2017 Year to Date	Last 12 months
Full Yield Curve	+37.1%	+2.3%	+4.7%
Averaged Yield Curve	+33.5%	-0.3%	+2.9%
Adjusted Average Yield Curve*	+1.4%	0.0%	+2.6%
Corporate Financial Yield Curve	+40.8%	-0.6%	+4.3%

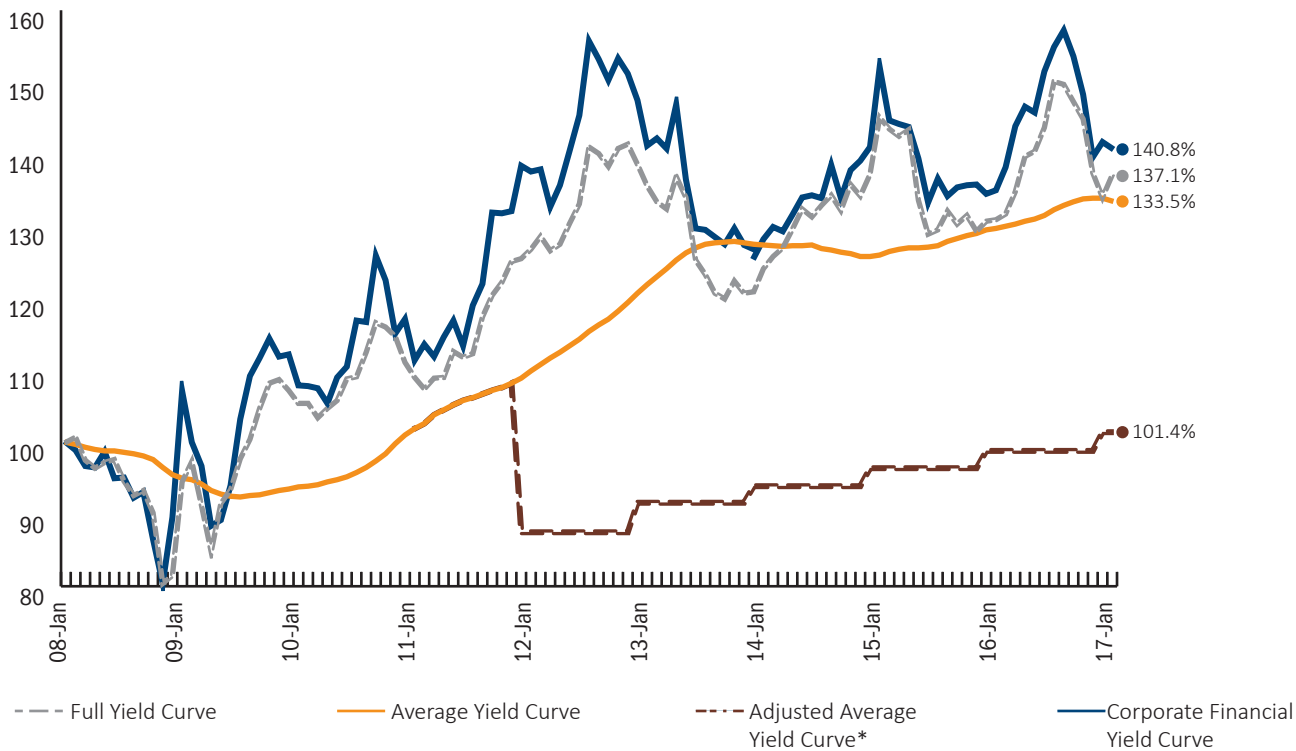
The BPS&M Pension Liability Index is updated regularly. If you have questions or comments concerning the BPS&M Pension Liability Index, please contact your BPS&M consultant or jeffrey.p.thornton@bpsm.com.

Jeffrey Thornton, FSA, EA, MAAA

Jeff has more than 10 years of actuarial experience in defined benefit plan administration. He specializes in liability studies and has provided plan-specific analyses for clients of various sizes and diverse industries. Jeff is a consulting actuary in our Louisville, KY office.



BPS&M Pension Liability Index Since Inception



* Reflects funding relief

The BPS&M Pension Liability Index is provided for informational purposes only by BPS&M, a Findley Davies Company. BPS&M and its affiliates do not make any warranties as to the accuracy or adequacy of the BPS&M Pension Liability Index or its fitness for a particular purpose.



5301 Virginia Way, Suite 400
Brentwood, Tennessee 37027

Subscribe to eDevelopments, our newsletter. Same articles, faster delivery! Email us at edevelopments@bpsm.com

Developments

Recent Developments in Employee Benefits

About BPS&M

Bryan, Pendleton, Swats & McAllister, LLC is a Findley Davies Company. Findley Davies | BPS&M has been providing actuarial and benefit consulting services to clients since 1969.

Jackson Suite 266 Highland Village, 4500 I-55 N, Jackson, Mississippi 39211, 601.981.2155
Louisville 11807 Brinley Avenue, Suite 101, Louisville, Kentucky 40243, 502.244.7828
Nashville 5301 Virginia Way, Suite 400, Brentwood, Tennessee 37027, 615.665.1640

Contact us via email at developments@bpsm.com

Developments is furnished by Bryan, Pendleton, Swats & McAllister, LLC (BPS&M), a Findley Davies Company, to provide general information about recent developments and current topics in employee benefits. The information provided is a summary and should not be relied upon in lieu of the full text of a particular law, regulation, notice, opinion, legislative proposal or other pertinent information, and the advice of your legal counsel. BPS&M does not practice law or accounting, and this publication is not legal or tax advice. Legal issues concerning your employee benefit plans should be discussed with your legal counsel. This publication is intended for informational purposes only and is in no way intended to offer investment advice or investment recommendations.