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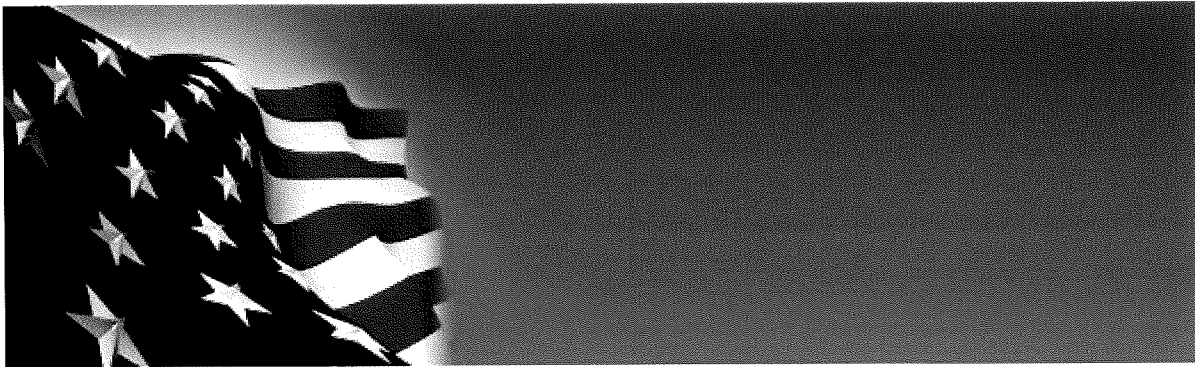
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CYPEN & CYPEN NEWSLETTER for JULY 16, 2015

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Stephen H. Cypen, Esq., Editor

Never Forget September 11, 2001

and

Always Remember May 2, 2011

1. LIABILITY DECREASE DRIVES INCREASE IN PENSION FUNDED STATUS: Public pensions and foundations and endowments suffered from low returns according to plansponsor.com. The funded status of the typical U.S. corporate pension plan increased 1.5 percentage points in June to 87.8%, according to the BNY Mellon Investment Strategy and Solutions Group. Liabilities declined more rapidly than assets during the month. The June BNY

Mellon Institutional Scorecard is the first to reflect a realignment in the December 2014 funded status for the typical U.S. corporate plan resulting from recent changes in mortality tables produced by the Society of Actuaries to estimate life expectancies. These longer life expectancy assumptions caused a 5-percentage-point reduction in the December 2014 funded status, which was then carried forward. Additional revisions are expected as more companies adopt these changes in the mortality tables. For the typical U.S. corporate plan, assets in June fell 2.1%, while liabilities declined 3.8% as the Aa corporate discount rate rose 29 basis points to 4.49%. This was the fifth consecutive month for a rise in the discount rate and the third consecutive month in which most asset classes outperformed the liability at the typical corporate plan. The significant rise in the Aa corporate discount rate in June continued the momentum toward lower liabilities. Discounting the impact of the new mortality tables, the funded status of typical corporate plans continues to improve because of the declining liabilities. Public defined benefit plans in June missed their return target by 2.3% as assets declined 1.7%, according to the monthly report. Year over year, public plans are 6.8% below their annual return target. For endowments and foundations, the real return in June was -2.0% as assets fell 1.3%. Year over year, endowments and foundations are behind their inflation plus spending target by 5.6%.

2. WHY ARE OLDER AMERICANS' RETIREMENT INCOME SHORTFALLS EVERYONE'S PROBLEM?: As reported in plansponsor.com, a survey from the CFA Institute and Mercer finds a lack of retirement income could put a drag on capital markets over the next five years (and likely longer), driving financial stress for individuals and entire economies. The 2015 Global Market Sentiment Survey asked CFA Institute members to identify the most underestimated risk that could negatively impact global capital markets in the next five years. Fully 20% pointed to the impact from the demographic trends of aging populations, and another 14% designated pension plan shortfalls and low levels of retirement savings as leading threats to global investors. Mercer and the CFA Institute conclude quite simply, retirement is an issue too big not to address. Beyond dragging down quality of life at the upper end of the age scale -- insufficient retirement savings may lead to lower demand and economic output in general from economies across the globe.

One positive force at work is the increasing interest of Millennials in investing and saving, especially considering Millennials are the first U.S. generation to match the Boomers' size. But with persistently high global unemployment and stubbornly flat wages, younger workers in the U.S. and abroad face some concerning headwinds. The major causes of this demographic shift are declining birth rates and increasing longevity. A growing proportion of almost every country's population is entering retirement and therefore not directly contributing to their respective economy's production. At the same time, most retirees are looking to maintain their pre-retirement living standard and to have access to quality medical and aged care services in their later years. It is not a good mix, but the report also finds there are potential solutions to the global retirement problem. First and foremost, government officials should give up the notion that a single system -- either across countries or within one country -- will be able to pick up the massive amount of retirement income slack. In the U.S. this debate often plays out along the lines of defined contribution versus defined benefit. Which will lead us to a secure retirement future? Researchers says neither -- at least not individually. The report argues both systems will have to be strengthened and supported, and combined with other key sources of potential retirement income, to drive better retirement readiness. A more ideal system draws on three pillars. Pillar one is a mandatory participation, publicly managed and tax-financed pension system. Pillar two is a mandatory privately managed workplace benefit, and pillar three is voluntary personal savings funded beyond the private workplace benefit. In some respects this is already the system in place in the U.S. People are generally required to contribute to the Social Security system, which functions as a tax-financed pension system. But, problematically, neither the defined benefit nor defined contribution systems are mandatory, nor do they extend widely enough to ensure everyone gets an equitable shot at a successful retirement. Figures showing upwards of 40% of private sector workers still lack access to an institutional workplace savings options. The government must establish clear objectives for the whole retirement system, including the complementary roles of each pillar. Especially important is to incorporate the provision of a minimum income to alleviate poverty among the aged population, along with insuring there is sufficient competition between investment and administration services providers, in the interest of keeping down costs. One other

complicating factor in the U.S. is the bullheadedness of the national identity. In other words, here in the United States people do not like to be told what to do or how to behave. This holds true across so many aspects of our society that it is no surprise the U.S. has not gone the way of Australia or other modern economies to implement a mandatory retirement savings system for all workers. Even seeing the pretty impressive statistics coming out of Australia probably is not going to change this any time soon. That is why the path forward in the U.S. is going to rely heavily on things like automatic enrollment and heavier use of defaults. Default is very different from mandatory, it is very hard to see a full-fledged mandatory system coming into the picture here in the near future, but we have already seen a lot of success getting people saving through default features. Greater use of defaults is essential to improving our outlook in the U.S.

3. IRS SHUTS THE DOOR ON LUMP SUM WINDOWS FOR RETIREES: The IRS issued Notice 2015-49, effectively overturning a stream of Private Letter Rulings issued since 2012 (the widely known Ford/GM Rulings) where the IRS had ruled that a qualified defined benefit plan could be amended to permit a participant in pay status to elect to commute the remaining value of the annuity payments to a lump sum payment during a temporary "window period." This type of amendment -- to permit participants/beneficiaries in pay status to elect a lump sum that was not otherwise available under the terms of the plan -- is often referred to as a "de-risking" amendment and is no longer permitted, generally effective July 9, 2015. Importantly, plan sponsors can continue to provide these lump sum windows for participants that are not in pay status (e.g., deferred vested participants). This change in position is likely tied to government concerns that retirees are ill-prepared to manage lump sum distributions and the view that continued lifetime pension payments are a critical part of an individual's financial security during the retirement years. The Notice is primarily a result of continued lobbying by retiree groups to get some action at a policy level to slow this trend. The release was certainly kept under close wraps -- unlike most published guidance in development. As a result of this Notice, plan sponsors can no longer transfer the risks of increased longevity and investment loss to participants already in pay status. The IRS will be issuing proposed regulations to clarify the scope of this new restriction. In the past few years, many plan sponsors have been

focusing on financial/benefit strategies to "de-risk" their pension plans. The focus on "de-risking" arises primarily because of:

- increasing asset volatility,
- increased retiree longevity (and pending mortality table changes),
- recent changes in accounting and funding rules, and
- concerns about ongoing benefit liabilities and their potential impact on the value of the plan sponsor's securities.

Still other factors include increasing PBGC premiums under the recent highway legislation and communication costs for inactive participants. The concept of "de-risking" includes more traditional strategies such as liability-driven investing, and annuitizing accrued benefits (which can be costly, but completely shifts the liability risk to a third party), and the newer "annuity buy-in" where the insurer and plan sponsor share the risks. At issue here is the method to manage risk by cashing out pensioners altogether, effectively shifting the investment and longevity risks to them. One significant area of uncertainty with regard to de-risking has been whether a lump sum option could be offered to participants in pay status. Treas. Reg. section 1.401(a)(9)-6, Q&A-1 (a) states that once payments begin, they cannot be changed and must be non-increasing. However, there are exceptions to this general prohibition. As relevant here, Treas. Reg. section 1.401(a)(9)-6, Q&A-14(a)(4), includes an exception for increases that result from a plan amendment. In several rulings, the IRS ruled that this exception applies to a plan amendment implementing a temporary lump sum window feature, provided certain requirements are met. Accordingly, prior to this Notice, participants in pay status could be provided the opportunity to elect a lump sum option. The Notice states that the IRS intends to amend the required minimum distribution regulations under Internal Revenue Code section 401(a)(9) to provide that "qualified defined benefit plans generally are not permitted to replace any [annuity payment] currently being paid with a lump sum payment or other accelerated form of distribution. " Specifically, the Notice states that "the IRS intend to propose amendments to section 1.401(a)(9)-6, Q&A-14(a) to provide that the types of permitted benefit increases described in that paragraph include only those that increase the ongoing annuity payments, and do not include those that accelerate the annuity payments [emphasis added]." However, the Notice suggests that it may amend Reg. section 1.401(a)(9)-6, Q&A-13, as

well, which is the provision that allows changes to distributions upon plan termination. As a result, the Notice is not entirely clear whether the IRS might change the regulations to limit a plan sponsor's ability to offer a lump sum cashout for annuitants in pay status at the time of plan termination, but we do not anticipate any changes and will seek clarification in the pending regulations. As a number of plan sponsors have been actively pursuing de-risking strategies this year, the effective date of the guidance is of particular importance. This guidance is effective July 9, 2015, but with limited exceptions if certain activities were underway at the time of the Notice (called Pre-Notice Acceleration). Specifically, a lump sum window for retirees is still permissible (and will not raise a plan qualification concern under Code section 401(a)(9)) if:

- the amendment was adopted or authorized by an entity with authority to amend the plan prior to July 9, 2015,
- with respect to which a private letter ruling or determination letter was issued (not submitted) by the IRS prior to July 9, 2015,
- with respect to which a written communication to affected plan participants stating an explicit and definite intent to implement the "derisking" program was received by those participants prior to July 9, 2015, or
- the amendment was adopted pursuant to an agreement between the plan sponsor and a union representative entered into and binding prior to July 9, 2015.

The Notice also expressly provides that any private letter ruling or determination letter issued by the Service or Chief Counsel will now generally include a caveat expressing no opinion as to the federal tax consequences of a lump sum risk-transferring program. But the IRS/Chief Counsel may still provide a determination that any Pre-Notice Acceleration satisfies the MRD requirements. Lastly, the Notice expressly states that it does not provide any guidance on the tax consequences of a lump sum risk-transferring program under the various other sections of the Code -- including 401(a)(4) (nondiscrimination rules), 411 (non-forfeiture), 415 (benefit limitations), 417 (spousal protections), and 436 (benefit restrictions). Any company planning to amend its qualified defined benefit plan to provide for a temporary lump sum benefit will now have to limit eligibility for the lump sum option to participants who have not commenced distributions. Although the Notice provides MRD relief for

situations where an entity has authorized such a window benefit as of July 9, 2015 (Pre-Notice Acceleration) -- it is important to highlight that there are a number of Code provisions that need to be carefully considered in implementing lump sum windows. Additional issues may surface when the proposed regulations are actually issued, so stay tuned.

4. IRS WEBINAR ON CORRECTING RETIREMENT PLAN MISTAKES: On August 4, 2015 at 2:00 p.m. Eastern Time, the Internal Revenue Service will hold a free webinar about Revenue Procedures 2015-27 and 2015-28 modifications to Revenue Procedure 2013-12 to encourage voluntary compliance by:

- Promoting early correction of elective deferrals failures in retirement plans, including auto enroll plans
- Making it easier to fix ongoing IRC 415 annual addition limit failures in certain plans
- Clarifying the rules for recovering certain overpayments paid to plan participants
- Paying reduced compliance fees under the Voluntary Correction Program for required minimum distribution failures and certain participant loan failures

Register and you will receive a confirmation at: <https://www.webcaster4.com/Webcast/Page/925/9463>.

5. ON SECOND THOUGHT...MAYBE THEY WERE WRONG?: We do not like their sound, and guitar music is on the way out. -- Decca Recording Company on declining to sign the Beatles, 1962.

6. APHORISMS: No one has more driving ambition than the teenage boy who wants to buy a car.

7. TODAY IN HISTORY: In 1990, Empire State Building catches fire -- no fatalities.

8. KEEP THOSE CARDS AND LETTERS COMING: Several readers regularly supply us with suggestions or tips for newsletter items. Please feel free to send us or point us to matters you think would be of interest to our readers. Subject to editorial discretion, we may print

them. Rest assured that we will not publish any names as referring sources.

9. PLEASE SHARE OUR NEWSLETTER: Our newsletter readership is not limited to the number of people who choose to enter a free subscription. Many pension board administrators provide hard copies in their meeting agenda. Other administrators forward the newsletter electronically to trustees. In any event, please tell those you feel may be interested that they can subscribe to their own free copy of the newsletter at <http://www.cypen.com/subscribe.htm>.

10. REMEMBER, YOU CAN NEVER OUTLIVE YOUR DEFINED RETIREMENT BENEFIT.

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**777 Arthur Godfrey Road
Miami Beach, Florida 33140
Telephone/Miami-Dade: 305.532.3200
Telephone/Broward: 954.522.3200
Telephone/Toll Free: 800.332.3200
Telecopier: 305.535.0050
www.cypen.com
info@cypen.com**

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