# Developments

Recent Developments in Employee Benefits

*Part I*

# Employee Benefits under the New Administration

By Sheila M. Ninneman, JD

*With the first 100 days of the Trump Administration behind us, we're gazing into our crystal ball to see what the future might hold for employee benefits under the new administration. This is the first article in our two-part series. Stay tuned for our next issue, where we'll look into the future of health and welfare benefits.*

In the employee benefits arena, the Trump Administration has had laser-like focus on health care. Given the recent failure (and subsequent revival) of President Donald Trump's promise to repeal and replace the Affordable Care Act, you may be sitting in your recliner, content (or not) that the current employee benefits regime of executive compensation and private retirement plans is here to stay for the foreseeable future. But your recliner better have a seat belt because you'd be wrong. Buckle up!

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The domestic agenda of the Trump Administration and a Republican-led Congress is promising to make sweeping changes to the familiar arena in which retirement plans and executive compensation have been operating or, in the case of the fiduciary rule, were about to operate. The better known changes will come mostly in the guise of cuts to the federal budget, tax reform, and measures aimed at deregulation—particularly deregulating Wall Street. Lesser known changes lurk in bills proposed by Republicans in the prior Congress that we feel are sure to be revived.

Of course, much of what we write here is informed soothsaying. Whatever the Trump Administration proposes in the way of budget cuts and the further deregulation of Wall Street will be, no doubt, subject to the alchemy of Congress as the proposals make their way into legislation. After all, not everything can be done through Executive Order (EO).

In addition, the information we have from the Trump Administration at this time consists largely of guidelines and suggestions, which reflect more policy perspective than specific policy prescriptions. What the policy statements lack in detail, however, they more than make up for in boldness.

## Federal budget cuts

On March 16, 2017, the White House released the 2018 Budget Blueprint provided by the Office of Management and Budget (OMB). The Budget Blueprint is more or less the Trump Administration's wish list. The current budget process requires that the Congressional Budget Office analyze the President's budget request and issue a report to each of the budget committees in the House and the Senate. The goal is for each of the committees to then pass budget resolutions that will be considered, and hopefully reconciled, by select members of both the House and the Senate by sometime in April. After passing through appropriation committees in the House and the Senate, a conference committee takes up the resulting appropriation bills from each of the bodies, and again reconciles any differences.

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Once the conference bill passes both the House and the Senate it will go to President Trump for signature. This long and arduous process can mean that the final legislative product will barely resemble the President's Budget Blueprint; however, at this juncture, this is all we have to go on. For our purposes, the most important features of the Budget Blueprint are the President's intentions for the Department of Labor (DOL) and the Internal Revenue Service (IRS).

*The Department of Labor*

Included in the Budget Blueprint is a proposed 21 percent ($2.6 billion) cut to the DOL. Although the Employee Benefits Security Administration (EBSA) is not specifically named as a targeted DOL program, the cuts to the listed programs only total approximately $600 million. It is unclear where the DOL would make additional cuts to satisfy the remaining $2 billion deficit in its funding.

If the DOL were to take the position that the remaining $2 billion budget reduction should be levied across the board, the impact on the EBSA would be significant. That seems counter-intuitive, as the EBSA's budget is only approximately 1.5 percent of the entire budget for the DOL. If the EBSA is asked to take its share of the $2 billion cut, however, it will take an approximately $30 million hit or roughly 17 percent of its budget. Such a cut would mean a precipitous reduction in DOL audits and enforcement. There simply would not be the personnel to conduct the kind of audit activity that we have witnessed in the past few years.

*The Department of the Treasury*

The Budget Blueprint recommends a cut of just 4 percent to the Treasury Department budget. Of that approximate $600,000 reduction, the IRS is targeted for nearly half. Given that the IRS budget is approximately $13 million, the cut amounts to approximately 4.6 percent of its budget. Enforcement represents almost the same percentage of the IRS budget. It would seem, therefore, that the recommended cut to the IRS would change little in the way of enforcement—unless the IRS determines that segment of the agency will bear the brunt of the funding reduction.

## Tax reform

Although the Trump Administration has announced that it is pivoting from the failed American Health Care Act to tax reform, there is little information regarding President Trump's proposals regarding tax reform. At this date, the only detailed information regarding proposed tax reforms includes a drop in the corporate tax rate from a high of 35 percent to a high of 15 percent. A second proposal would allow multinationals to repatriate approximately $2.5 trillion in overseas capital to the U.S. at a tax rate of 10 percent. The third proposal is to reduce the seven-tier ordinary income tax bracket system to a three- or four-tier bracket system.

The impact of these proposed changes on employee benefits is unclear. At best, a reduction in individual tax rates could result in increased contributions to health savings accounts and 401(k) retirement savings plans. Whether more targeted employee benefits provisions will be tucked into the budget reconciliation bill is anyone's guess.

*At best, a reduction in individual tax rates could result in increased contributions to health savings accounts and 401(k) retirement savings plans.*

## Deregulation

One of President Trump's first acts, on January 20, 2017, was to issue a memorandum to all executive departments and agencies that instructed them to freeze all new or pending regulations until the Trump Administration has the opportunity to review them. This kind of memorandum is common for a new administration that follows the administration of the opposite party. Specific frozen regulations affecting employee benefits are described in more detail below.

In a related move, President Trump signed an EO on January 30, 2017, which aims to reduce and control regulatory costs. The EO requires that, unless otherwise required by law, whenever an executive department or agency proposes for notice or comment or otherwise issues a new regulation, it will simultaneously identify two existing regulations to be repealed. The EO further requires that the incremental cost of new regulations, including repealed regulations in 2017, be $0 unless otherwise required by law or approved by the Director of the OMB. There are many questions regarding the implementation of this EO, including the fact that the EO is so vaguely written it is unclear what, exactly, is considered a new regulation.

On February 8, 2017, the Natural Resources Defense Council, the Communications Workers of America, and Public Citizen sued President Trump in the U.S. District Court for the District of Columbia seeking to block the

EO. Assuming it is not blocked by the court, this EO will undoubtedly affect employee benefits beyond the regulations described below, but it is impossible to predict how until the impacted departments and agencies begin to act on the EO's directives.

Two specific regulatory areas in which the Trump Administration's aversion to regulations is clear and direct have been widely covered:

- The DOL's new fiduciary rule, now delayed from an April 17, 2017, applicability date
- Certain rules under the Dodd-Frank Act

*The Fiduciary Rule*

In April 2016, the DOL finalized significant changes to the definition of a fiduciary that would apply to both ERISA-governed plans and individual retirement accounts (IRAs). The broader definition affects a much larger group of institutions and advisors who could now be considered fiduciaries, because it expands the scope of actions that are considered fiduciary acts. Forced to assume fiduciary responsibilities, the newly expanded group would also be subject to potential liability, and the price of that liability is high. Fiduciaries who do not follow the basic standards of fiduciary conduct may be personally liable to restore any losses to a plan or IRA or to restore any profits made through improper use of a plan's or IRA's assets resulting from their actions. Exemptions from the self-dealing prohibited transactions in ERISA and the Internal Revenue Code issued with the final regulations include requiring individuals and institutions affected by the expanded definition to enter into a Best Interest Contract with their customers and to disclose their business structure and compensation policies in connection with conflicts of interest posed by any fee or compensation practice.

*The new fiduciary rule was one of the Trump Administration's first targets.*

The new fiduciary rule was one of the Trump Administration's first targets. On February 3, President Trump issued a memorandum directing the DOL to:

1. Examine the new fiduciary rule to determine whether it adversely affects access to retirement and financial advice
2. Prepare an economic and legal analysis concerning the impact of the fiduciary rule
3. Rescind or revise the fiduciary rule following the appropriate review procedures

Circumstances that countervail the directive of the President come from inside the Trump Administration and from the courts. On February 9, the OMB considered the economic impact of the Trump Administration's directive to the DOL to delay and reexamine the fiduciary rule. It concluded that the economic impact of the delay would be significant, which is generally defined as having an adverse annual impact of $100 million or more or to adversely affect in a material way a sector of the economy. Because of this conclusion reached by the OMB, it may be more difficult for the Trump Administration to unravel and repeal the rule. Moreover, as of February 9, the rule had been upheld in three judicial challenges, which means that the courts are unlikely to assist in the takedown of the rule.

On March 1, the DOL proposed to delay the April 10, 2017, applicability date for the fiduciary rule for 60 days. Eight days later, the DOL issued Field Assistance Bulletin (FAB) No. 2017-01 regarding a temporary enforcement policy. The FAB provides that the DOL will not take enforcement action for noncompliance with the fiduciary rule from April 10, 2017 to the date that a final rule extending the applicability date is published. In addition, if the DOL does not issue a final rule regarding an extended applicability date, the DOL will not take any enforcement action for noncompliance, provided the rule's requirements are met within a reasonable period after the publication of the decision not to delay.

On March 28, the IRS announced a nonenforcement policy with regard to the assessment of excise taxes in connection with prohibited transactions impacted by the DOL's temporary enforcement policy. Private lawsuits arising out of contractual rights have not been affected by the policies announced by the DOL and the IRS.

On April 4, the DOL extended the applicability date for the fiduciary rule to June 9, 2017. April 17 marks the deadline for when comments are due for consideration by the DOL in its study of the rule (as required by the February 3 memorandum). Depending on the result of the study, the DOL will either allow the rule to take effect on June 9, 2017, issue a further delay of its applicability date, propose to modify the fiduciary rule, or withdraw it completely.

Until we learn otherwise from the DOL in the coming two months, the fiduciary rule's requirements around the expanded fiduciary definition and impartial conduct, including prohibited transaction exemptions, will be fully applicable on June 9, 2017. Note, however, compliance with many of the disclosures and supervision policies, as well as executing a Best Interest Contract will continue to have an effective date of January 1, 2018.

It should be noted that in addition to the regulatory directives issued by the Trump Administration, numerous bills introduced in the prior Congress could be reintroduced in this, the 115th Congress, that could establish a new definition for fiduciary, or, as in the case of one bill introduced earlier this year, delay the effective date for the DOL's fiduciary rule for two years following the bill's enactment.

Without question, the legislative and regulatory landscapes create tremendous uncertainty for individuals and entities that have been preparing for the past year to comply with the new rule. In that respect, they should recall that the DOL's enforcement actions are circumscribed by FAB No. 2017-01.

### *Dodd-Frank's Executive Compensation Provisions*

In another EO, also issued on February 3, 2017, President Trump directed the Secretary of Treasury to report, within 120 days on whether governmental rules and policies promote or inhibit the EO's core principles of investor choice, economic growth, and international competition, as well as the more traditional goals of financial regulation, such as preventing bailouts, analyzing risk, and increasing accountability. Although rules under the Dodd–Frank Wall Street Reform and Consumer Protection Act (Dodd-Frank) are not mentioned by name in the EO, President Trump stated, in conjunction with the issuance of the EO, that Dodd-Frank rules would be subject to significant cuts.

> *President Trump stated, . . . that Dodd-Frank rules would be subject to significant cuts.*

Dodd–Frank is aimed in large part at banking institutions. It tightens rules regarding bank capitalization (the amount of money that banks must have in reserve), compliance and reporting standards, and mortgage requirements, created the Consumer Financial Protection Bureau, curtails excessive risk-taking, and heavily regulates institutions on Wall Street that are so-called too-big-to-fail.

***Pay Ratio Disclosure.*** Rules under Dodd-Frank also significantly affect the executive compensation arena. One of the most controversial requirements is the pay ratio disclosure report. The first reporting period is to be the full first fiscal year beginning on or after January 1, 2017. In general, the required disclosure includes:

1. The median of the annual total compensation of all employees, except the chief executive officer (or equivalent position)
2. The annual total compensation of the chief executive officer (or equivalent position)
3. The ratio of the two amounts

Many observers note that the pay ratio disclosure is based, in part, on law other than Dodd-Frank, so that the repeal of Dodd-Frank will not be enough to repeal the rule, and additional legislative action will be necessary to gut the rule. That legislation could come in the form of the CHOICE Act, already revised once since its September 2016 roll-out in from the House Financial Services Committee. Given the current state of Congress and the priorities of the White House, it may be some time before such legislation makes its way through both the House and the Senate. For now, public companies subject to this rule, especially calendar-year companies, should plan on complying with the disclosure requirement.

***Say-on-Pay.*** Dodd-Frank's Say-on-Pay rule became effective nearly six years ago and has become an accepted part of corporate governance. The rule requires that shareholders have the right to a nonbinding vote on executive compensation at least once every three years. The CHOICE Act, which incidentally Speaker Paul Ryan has embraced as part of his Better Way agenda, would limit such votes to the occurrence of material changes to a company's executive compensation. Because of its popularity with institutional investors, Say-on-Pay may be phased out over time, but for now, it is still firmly in place.

> *Because of its popularity with institutional investors, Say on Pay may be phased out over time, but for now it is still firmly in place.*

Many Dodd-Frank rules, including those on pay-versus-performance disclosure and clawback policies, are still in proposed form. Given the Trump Administration's directive regarding regulations, there is little chance that the proposed regulations will go anywhere. In addition, the CHOICE Act includes a specific provision limiting the parameters of Dodd-Frank's requirement that a company adopt a clawback policy. The original policy mandates that, in the event a company is required to prepare an accounting restatement due to material noncompliance with any financial reporting regulations under the securities laws, the company would recover—from any of its current or former executive officers—any incentive-based compensation (paid during the preceding three-year period) in excess of what would have been paid under the accounting restatement. The CHOICE Act would subject only those executives responsible for the erroneous financial reporting to a clawback policy.

## Recent proposals affecting retirement plans and executive compensation

Although the Trump Administration has not issued an EO, memorandum, or blueprint directly targeting the country's public and private retirement systems, it has been reported in multiple sources that the Republican-led Congress will use the budget reconciliation process to cut the defined benefit pension benefits of federal employees. In addition, it may be possible to find clues as to what the future holds for the country's private retirement system in bills introduced by the Republican Congress in the last two years.

The Retirement Security for American Workers Act was introduced on February 3, 2017 by a group of bipartisan members of the House of Representatives. The bill modifies qualification requirements for a multiple employer retirement plan (MEP), which is either a multiple employer defined contribution plan, or a plan consisting of multiple IRAs. The proposed legislation addresses concerns raised regarding a pooled employer plan (PEP) that had been introduced in earlier proposed legislation. In that regard, a MEP can either be sponsored by employers with a common interest or by a pooled plan provider. In addition, if one of the employers is noncompliant, the bad actor can be required, subject to the approval of the IRS, to transfer plan assets attributable to its employees to separate plans or be held liable for liabilities associated with its employees. The proposed legislation gives small employers a more affordable alternative to traditional qualified retirement plans in order to encourage their employees to save for retirement.

On April 6, 2017, the Lifetime Income Disclosure Act was introduced by two members of the Senate from opposite sides of the aisle. If enacted, the bill requires 401(k) plan sponsors to notify participants annually of their projected monthly income at retirement based on their current account balance. The bill's sponsors stated that the bill will encourage increased savings when participants are better informed of how far their retirement savings will stretch.

### *Retirement Enhancement and Savings Act of 2016*

During the last quarter of 2016, two bills were introduced by Republican lawmakers and considered by the Senate Finance Committee. The first bill is the Retirement Enhancement and Savings Act of 2016 (RESA). It is a comprehensive bill that is intended to improve the retirement system in general. The RESA includes the following provisions:

- Require annual benefit statements that include an estimate of the amount of monthly annuity income that a participant's defined contribution plan balance could produce in retirement
- Create a fiduciary safe harbor for defined contribution plan sponsors that includes a lifetime income investment option
- Change the post-death required minimum distribution rules to require that all distributions after death (including to a designated beneficiary) be made by the end of the fifth calendar year following the year of death (with certain exceptions)
- Eliminate the 10 percent limit on the automatic enrollment safe harbor default rate
- Extend the period during which a qualified plan loan offset amount can be contributed to an eligible retirement plan
- Permit employers to adopt a four percent nonelective safe harbor contribution for the plan in the prior year
- Direct the Department of the Treasury to eliminate the provision in hardship regulations that prevent a participant from making elective deferrals for six months after receiving a hardship distribution

Other provisions eliminate the notice requirement applicable to nonelective contribution 401(k) safe harbor plans, and create new limits on plan loans made via credit cards.

### *Miners Protection Act of 2016*

The second bill is the Miners Protection Act of 2016, which is designed to provide support to the Mineworkers of America's retiree health and pension funds, which are both facing insolvency in the near term. Because Kentucky, West Virginia, western Pennsylvania, and their mining constituencies provided President Trump with stalwart support during his campaign, the Trump Administration may be motivated to assist this bill in making its way to his desk.

*Empowering Employees through Stock Ownership Bill*

Before recessing in the fall of 2016, the House passed the bipartisan Empowering Employees through Stock Ownership Bill. The bill would allow certain employees of private corporations that have broad-based equity plans to elect to defer income attributable to stock received upon exercise of a stock option or settlement of a restricted stock unit for up to seven years. Although the bill died in the prior Senate, it may be revived for consideration in this Congress.

*Tax Reform Act of 2014*

On February 26, 2014, former House Ways and Means Committee Chairman, Dave Camp (R-MI), introduced the Tax Reform Act of 2014. This comprehensive bill includes several general qualified retirement plan provisions, as well as several executive compensation provisions.

With respect to qualified retirement plans, Camp's bill would have eliminated the net unrealized appreciation rules on lump sum distributions of employer stock, required that all defined contribution plans allow Roth contributions, limited pretax contributions to just 50 percent of all contributions, eliminated certain types of plans (such as traditional IRA, SEP and SIMPLE 401(k) plans), and simplified rules around other plans (such as having one set of contribution limits for 401(k), 403(b), and 457(b) plans).

Executive compensation provisions would have eliminated the performance-based compensation exception to the $1 million annual compensation deduction limit and modified the definition of a covered employer.

The bill also would have revoked Section 409A, which generally allows deferral of taxation on vested compensation until the compensation is actually paid (assuming there is compliance with certain rules) and exempts nondiscount stock options and stock appreciation rights. Section 409A would have been replaced with Section 409B, which would tax deferred compensation—including stock options and stock appreciation rights—when the compensation vested and was no longer subject to a substantial risk of forfeiture. Under both Section 409A and the proposed Section 409B, deferred compensation would include not only traditional deferred compensation plans, it would also include severance payments paid in installments under an employment agreement.

The Tax Reform Act of 2014 was not a popular bill—even among Republicans, and it will be replaced undoubtedly by a tax bill that bears the stamp of the Speaker of the House, Paul Ryan. Still, where current tax reform conversations center almost exclusively on cuts to the taxes of corporations and the wealthy, the 2014 bill may provide clues as to the future direction of our private retirement system. Certainly, the measures comport with the spirit of President Trump's EOs on administrative regulations: simplify or eliminate.

## What does it all mean?

It is the conventional wisdom that businesses and investors crave predictability and steadiness in the economy from the government and on the global scene. Unfortunately, 2017 promises no such luxuries. With Republicans leading both the House and the Senate, and with President Trump in the White House, the long sought reform of the tax, administrative regulation, and private retirement systems is in reach. The proposals, as far as they are known, portend relatively radical changes to the employee benefits world as we have known it for some time. Buckle up, hang on to your seat, and keep your eyes open.

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# Disability—the Underappreciated Risk

By Katherine Tange-duPré, CEBS

***4,291,000.*** That's the number of working-age Americans who experienced a disabling injury or illness in 2016.[1]

That's a lot of disabilities, so let's put this in numbers that may be easier to comprehend:

- One out of every four of today's 20-year-olds will become disabled between now and their retirement
- One in eight workers will be disabled for five or more years during their working careers
- The average group disability claim lasts approximately three years[2]

Knowing this, I wonder why more than six out of every ten workers believe they have only about a two percent chance of being disabled for three or more months.

## Protecting workers against disability

How long could you survive financially if your income stream dried up today? Two weeks? Three months? Several years? In the case of injury or illness, disability insurance can mean the difference between financial security or poverty, especially if the disability lasts for months or years.

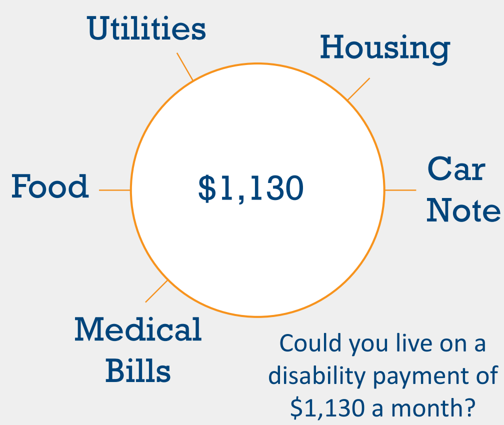
The "Employee Benefits Survey 2016," conducted by the International Foundation of Employee Benefit Plans (IFEBP), found that 78 percent of employers provide employees with short-term disability protection, which typically lasts for six months. Once short-term disability has run its course; however, an extended injury can quickly become a serious financial issue for employees who don't have adequate personal savings or long-term disability.

To protect employees from the financial ruin that can result from long-term disability, 63 percent of employers that participated in the IFEBP survey reported offering long-term disability benefits to their employees. Among employers that offer long-term disability to employees, rather than making it an automatic benefit, the trend is to offer coverage as a voluntary benefit that is typically paid for in whole or in part by employees. The downside of this arrangement is that many employees don't recognize the cost benefit of long-term disability plans and fail to take advantage of this undervalued benefit.

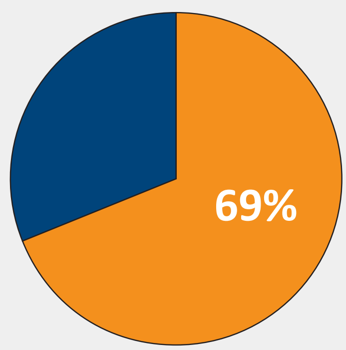
## For the disabled, the future can be grim

With generally higher unemployment rates and increased health care needs and costs, disability takes a


The average group long-term disability claim lasts **34.6** months.




The average monthly benefit paid by SSDI in December 2012 was **$1,130**.




**69%** of workers in the private sector have no private long-term disability insurance.

financial and emotional toll on the disabled as well as their family members. Many family members become primary care givers, further reducing household income. In the private sector, only about one in three employees are covered by an employer-sponsored long-term disability plan, and while Social Security may provide a small benefit, being approved is a difficult and lengthy process. The result is a high percentage of working-age disabled are poor. This not only affects their current standard of living, it also affects their future.

Depending on the type of retirement plan available to a disabled person, long-term disability may present a financial risk that goes beyond the months or years of working age disability and extend into retirement. If a disabled person is fortunate enough to participate in a defined benefit (DB) plan, the plan may make supplemental income payments during disability, and the individual may continue to accrue benefits or credit for service.

This typically isn't the case when an individual is covered by a defined contribution (DC) plan. Too often, when these individuals become disabled they:

- Stop making contributions to a DC plan during the disability period
- Take distributions from the plan to cover everyday living expenses

## That could change

Up until now, few DC plans have adopted a mechanism to continue contributions, but a 2014 final regulation issued by the IRS may change that. The IRS regulation addresses the tax treatment when a plan sponsor offers disability insurance from within the plan to insure future contributions under certain conditions. The insurance would be treated like a plan investment, with premium payments treated like any other investment option. In the event of a disability, benefit payments would be made to the trust to replace contributions that would have been made if the employee had not become disabled.[3] The IRS regulation provides an example illustrating how "Amounts to be paid to the trustee from the insurance contract with respect to a participant are equal to the sum of the elective, matching, and non-elective employer profit-sharing contributions that would have been made on the participant's behalf during the participant's disability. . . ."

The premium payments by the plan are not treated as taxable distributions and the benefits paid to the participant's account in the plan are treated as investment earnings rather than contributions as long as the participant elects to be covered by the disability insurance contract and:

- Premium payments under the contract are paid directly by the plan out of the participant's account
- Benefit payments (i.e. replaced contributions) are paid because the employee is disabled and unable to work
- Benefit payments to the participant's account cannot exceed the reasonable expectation of the annual contributions that would have been made if the participant was not disabled, reduced by any other contributions made on the participant's behalf

Prior to the final regulations, plan sponsors could continue contributions in one of two ways: they could self-insure contributions or purchase coverage outside of the plan; however, neither approach offers the level of financial protection available under the final regulations.

## In perspective

Disability is one of the most serious financial risks that working-age people face, but it is often ignored. Employers can help their employees by educating them about the risk disability poses to their long-term financial security and by offering and encouraging participation in group long-term disability insurance. Wellness programs that detect health risks before they become chronic conditions can reduce the risk of disability. And, thanks to regulations issued in 2014, it now may be easier for employers that sponsors DC plans to protect their workers from the short- and long-term financial ruin that often accompanies a disability.

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*[1] America's Disability Counter, Council for Disability Awareness, http://www.disabilitycanhappen.org/. Accessed December 13, 2016.*

*[2] Chances of Disability, Disability statistics, Council for Disability Awareness, July 3, 2013, http://www.disabilitycanhappen.org/chances_disability/disability_stats.asp. Accessed December 13, 2016.*

*[3] Internal Revenue Service final regulations (T.D. 9665), Tax Treatment of Qualified Retirement Plan Payment of Accident or Health Insurance Premiums, Federal Register, May 12, 2014, https://www.federalregister.gov/documents/2014/05/12/2014-10849/tax-treatment-of-qualified-retirement-plan-payment-of-accident-or-health-insurance-premiums Accessed December 14, 2016.*

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# Do You Need a Pay Strategy?

By Brad Smith, CPA

Have you ever wandered through dense, unfamiliar woods? You weave around trees, hop over streams, and climb over other obstacles until you no longer know where you are or how you got there. Confused, maybe even a bit afraid, your palms sweat, your heart pounds, and you wonder, "Which way do I go?"

At this point, you may be thinking that a compass would be a valuable tool to have. While a compass won't provide a clear path out of the woods (you will have to use your judgement, and you may not be able to travel in a straight line), it will point you in the direction you need to go.

Being an employer sometimes feels like being lost in the woods. There are so many unknown paths to navigate and obstacles to avoid. Two of the biggest obstacles, finding and keeping talent, are becoming increasingly tough challenges to manage.

So wouldn't it be nice to have a "talent" compass? Just a simple tool that could help employers in their struggle to attract and retain talent in a competitive job market?

Good news, there is a tool any employer can use: it's called a pay strategy.

*A well thought out pay strategy is designed to attract and retain key talent.*

A well thought out pay strategy is designed to attract and retain key talent. For most employers, this means having an understanding of what other organizations are paying and defining ranges of compensation by position so that managers can make informed business decisions on pay.

If you are like many employers, you want to pay all of your employees at or above market pay levels, but you simply can't afford it.

There are two ways you can combat this situation:

1. You can reduce headcount by laying off your less productive employees, thus allowing you to allocate some of their pay to others and hope your remaining employees are satisfied. (Caution: there are many factors to consider prior to using this option.)
2. You can develop a pay strategy (your compass) using market pay data to make business decisions when administering pay.

The second option, developing an effective pay strategy, provides a forum for management to think about how the organization will retain its best talent and recruit other great talent. In short, your pay strategy will point your organization in the direction it needs to move.

Keep in mind, however, that like the path through the woods, even the best pay strategy may need to be change course as needs (and markets) change. Significant market adjustments occur most often when positions are in high demand. A high demand position may be the result of fewer qualified candidates or changes to the business environment.

How should an organization administer its pay using a market based pay approach when the budget doesn't allow it to pay at a competitive level?

It's not easy, as there are many factors to consider. To stay on track, start with a written document that centers on your best strategy for managing pay issues and addresses the following decision points:

- Will you provide a general cost of living adjustment, and if so, how will that amount be determined?
- How will you differentiate pay for top performers compared to others? How are you going to determine your top performers?
- How will promotional adjustments be authorized? Will managers have free reign to provide promotions to employees, or will there be a system of checks and balances? What will be expected from an employee before he or she can be promoted?
- How will you budget for the different adjustments in order to provide the most value?
- How often will you perform a market study on your employees? How will the results be put into action?

Once you've documented your strategy, you can define your pay administration guidelines. These guidelines will help your organization manage its pay plans within its strategy. Effective administration is essential for your organization to execute its strategy to its full advantage.

## In perspective

Creating an effective compensation strategy with pay administration guidelines is an essential tool for any organization navigating the competitive landscape for talent. Yes, you may occasionally need to stray from the data to retain or attract certain individuals, but the important thing is that your organization's compass keeps you moving toward your strategic pay goals.

For more information about how we can help your organization create and implement an effective pay strategy, contact Brad Smith at 419.327.4414 or bsmith@findleydavies.com.

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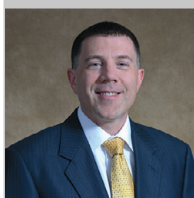
**Brad Smith, CPA**

*Brad joined Findley Davies in 2014 as part of the Consulting Team, providing assistance to all practice areas of the firm. Prior to joining the firm, Brad worked with several CPA firms performing audits in a variety of industries and served as Controller/Chief Operating Officer of a privately held business. He works to assist clients in enhancing financial performance and/or attracting and retaining human capital. Brad's work includes researching and analyzing compensation data, conducting competitive market analysis and creating total compensation reports. Brad is a licensed Certified Public Accountant and is a member of the American Institute of Certified Public Accountants (AICPA). Brad is based in the Findley Davies Toledo, OH office.*

### CONSULTANTS *in the* LIMELIGHT

**Sarah Powers** (BPS&M Nashville) has achieved the Associate of the Society of Actuaries designation.

**Ken Hohman** (BPS&M Louisville) represented the American Academy of Actuaries and Conference of Consulting Actuaries at the April 18–22, 2017 meeting of the International Actuarial Association in Budapest, Hungary.



**Matt Klein** (Findley Davies Cleveland ) and **Tom Swain** (BPS&M Nashville) presented at a Findley Davies webinar on March 30, 2017 titled *How to Properly De-Risk Your Plan: A Rainbow of Options*.

# The BPS&M Pension Liability Index

## *Updated as of March 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 funding relief under the Moving Ahead for Progress in the 21st Century Act (MAP-21), the Highway and Transportation Funding Act of 2014 (HATFA), and the Bipartisan Budget Act of 2015 (BBA 2015).
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 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 | +35.6% | +1.2% | +0.6% |
| Averaged Yield Curve | +33.0% | -0.7% | +2.1% |
| Adjusted Average Yield Curve* | +1.4% | 0.0% | +2.6% |
| Corporate Financial Yield Curve | +41.8% | +0.1% | -1.5% |

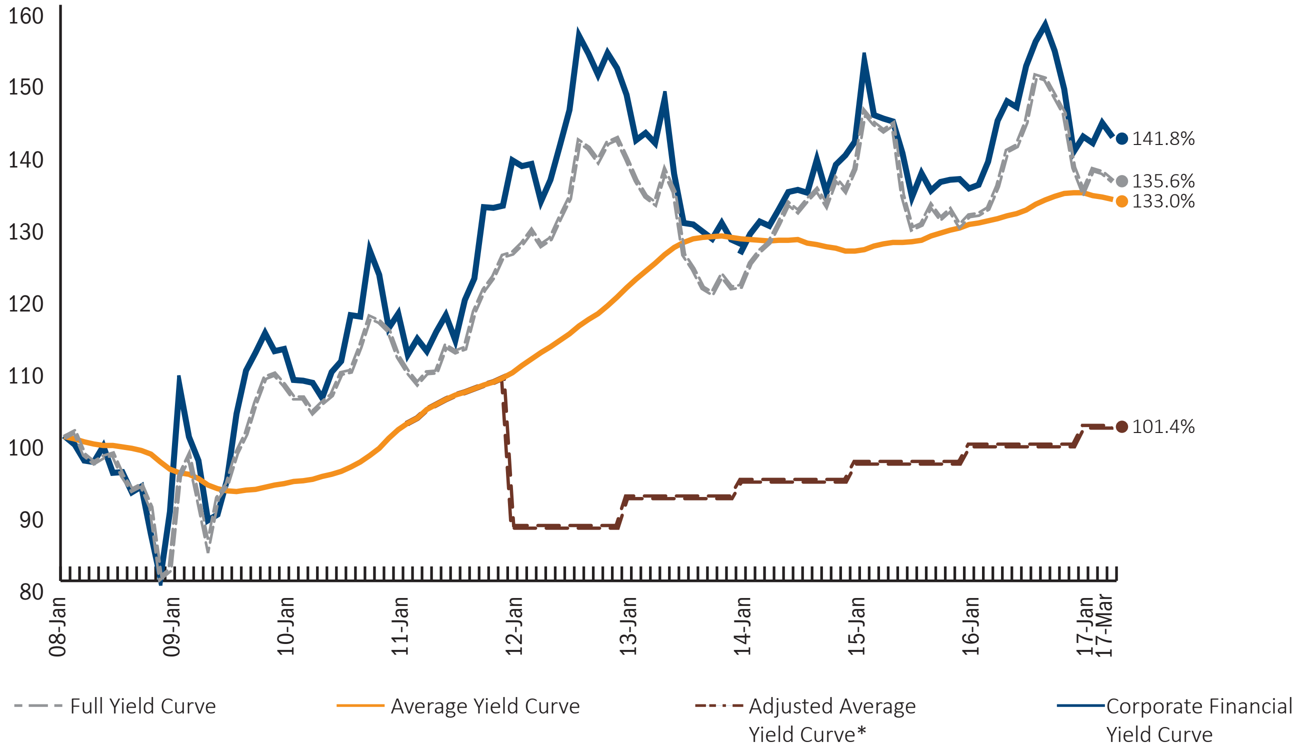
The trends demonstrated in the graph below will generally hold true for most pension plans, but the magnitude of the percentage changes will vary depending on a given plan's demographics and benefit accrual patterns.

The 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

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Recent Developments in Employee Benefits

## About BPS&M

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