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## Retirement Plan Outlook 2013: Potential for Tax Reform, Fiduciary Rule Re-Proposal on Practitioners' Minds

**T**he possibility of tax reform will be on everyone's minds in 2013 and retirement issues are bound to get swept up in the tide, practitioners told BNA in a series of interviews in the first half of January about their predictions for this year.

On the regulatory front, the retirement plan industry should expect the long-awaited re-proposal of the Department of Labor's fiduciary rule and the agency's guidance on lifetime income options. Practitioners also expect 2013 to be the year that the Treasury Department and Internal Revenue Service release final regulations on cash balance and other hybrid plans.

Pension funding relief could also come to the forefront this year, with the effects of funding stabilization provisions included in the Moving Ahead for Progress in the 21st Century Act (MAP-21) incrementally phasing out during the next several years, practitioners said.

While practitioners are sure about the general themes that will arise in 2013, they are unsure whether it will be a year of modest improvements in retirement benefits or, as some fear, a year in which reaching agreement on those fiscal issues will come at the cost of reduced limits on tax deferrals and tax deductions that support retirement income security policies.

### View From DOL

Phyllis C. Borzi, assistant secretary of labor for DOL's Employee Benefits Security Administration, said that she thinks the coming year will bring positive developments for retirement savings.

"We're actually feeling pretty optimistic. We think 2013 is probably going to be a good year for retirement savings. The economy seems to be improving. Hopefully more and more people now have jobs," Borzi said.

DOL is continuing its work on one of its most-talked-about projects, the re-proposal of the definition of the word "fiduciary" under Employee Retirement Income Security Act Section 3(21)(A). Borzi said the rule could appear as early as July, as indicated by DOL on its fall 2012 regulatory agenda (246 PBD, 12/27/12; 40 BPR 9, 1/1/13).

"We've been working on drafting what we call the operative language, the actual rules of the reg, the actual language that will be in the regulation. Our folks have spent a lot of time on the economic analysis. When we re-propose, what people will see in the economic analysis is a very clear explanation of what we think the

problem is, and a clear and robust evolution of the relative costs and benefits," Borzi said.

Along with the rule, DOL will propose "companion prohibited transaction exemptions," but Borzi was reluctant to indicate how many proposed PTEs will be included, because the rule is unfinished.

**'Critical Consumer Protection.'** Borzi called the fiduciary rule a "critical consumer protection," especially given the evolution of retirement plans during the past 30 years.

"The world has changed so much since the rule was adopted initially 30-plus years ago. We didn't have 401(k) plans. . . . The IRA [individual retirement account] market was just taking off," she said.

"The changes in the marketplace have just made it so very important that participants have access to good, solid, unbiased advice. . . . We really believe that this is very important," Borzi said.

Borzi said she was somewhat surprised by all of the negative reaction to the original proposal, which the department put forth in October 2010 (203 PBD, 10/22/10; 37 BPR 2305, 10/26/10). The department withdrew the proposal in September 2011 (182 PBD, 9/20/11; 38 BPR 1693, 9/20/11), citing the need for a more robust economic analysis, among other things.

"We knew that we were going to get push-back. You don't revisit, or modernize, or update—that's how I usually describe the rule—a rule that's been out there for a long time without getting some push-back. What I do think is interesting is the extent to which there has been such push-back," she said.

"Most people out in the marketplace that are giving advice really do think they're putting their clients' interests first, and if that's the case, then it's hard for me really to understand what the big fuss is, because that's all we're saying to people: Put your clients' interests first, and if you already doing it, it seems hard to understand why this would be such a radical departure," she said.

**'The Fiduciary Pot.'** Lynn D. Dudley, senior vice president for policy at the American Benefits Council, said she is not sure what to expect out of the new fiduciary rule but that the re-proposal will require an extensive dialogue before the rule is made final.

"I think in general they will not back off from their change, their shift in position with respect to the approach" to redefining the term fiduciary, she said.

Dudley said she thinks that DOL's proposal will assume everyone is in "the fiduciary pot" and that those who are not fiduciaries will "have to get plucked out by meeting certain requirements."

There needs to be a "meeting of the minds" about the approach to how to define a fiduciary in order to determine whether people qualify as fiduciaries under the definition, she said.

Dudley said a new fiduciary rule "is not a terrible thing" but that there needs to be "a lot more public dialogue" before the rule is finalized.

"So I'm really hopeful when the DOL does issue it that they give an ample opportunity to give feedback. That's the big issue there. They need to make sure they've given enough time to finish working it out. It's just a much better way to do things to try to have a cooperative dialogue back and forth between the regulators and those that are regulated. You'll get a much better result that way," she said.

Karen Friedman, executive vice president and policy director at the Pension Rights Center in Washington, said the re-proposal probably will be somewhat different from the original proposal, which her group supported. She echoed Dudley's comments about the need for public dialogue and said that PRC hopes that "there's going to be a process by which the right fiduciary rule is going to be constructed," which will mean "having a robust dialogue between the participant community and the financial industry."

"When it comes down to it, what we want to ensure is that those who are giving investment advice to people about their largest asset are doing so without conflicts of interest," Friedman said.

**Broker-Dealer Fiduciary Misperception.** While much attention has been paid to how broker-dealers fit into DOL's forthcoming re-proposal of the fiduciary rule, Kent A. Mason, a partner at Davis & Harman in Washington, said the real issue with regards to broker-dealers is being missed.

"There has been a perception that the issue is about whether broker-dealers are treated as fiduciaries or not and have a fiduciary duty to their client. That's actually not the issue," Mason said.

Mason said the concern in the brokerage community has focused on the fiduciary rule's impact on prohibited transaction rules under ERISA Section 406(b) and tax code Section 4975(c)(1) and whether any changes would prevent brokers from giving information to clients if they were deemed fiduciaries.

"The concern of the brokerage community has not been focused on, 'Do we have a fiduciary duty to our customers?' It has been much more focused on the fact that, under the DOL rules, if you're treated as a fiduciary, you can't give information at all because of the prohibited transaction rules," he said.

"So the key part about this is not the fiduciary duty; it's the fact that they simply could not give any information at all about that investment, and thus the investor would be cut off from all sorts of investment information," Mason said.

Because of these concerns, the prohibited transaction exemptions that will be coupled with the re-proposal will be critical, and one of the looming questions about the proposed PTEs is whether they will be broad enough, he said.

**Lifetime Income.** DOL also expects to release guidance on lifetime income options this year, Borzi said, and it most likely will come in the form of an advance notice of proposed rulemaking.

The most recent effort to address the issue began in 2010, when DOL and Treasury issued a request for information on how to turn defined contribution plans and IRAs into a lifetime stream of income for their participants through annuities (20 PBD, 2/2/10; 37 BPR 301, 2/9/10).

Treasury proposed the first component of the departments' joint project on lifetime income Feb. 2, 2012, issuing a guidance package of proposed rules and revenue rulings that are intended to remove regulatory barriers that may hinder individuals' abilities to save for retirement and to provide retirees with expanded options for managing their savings (22 PBD, 2/3/12; 39 BPR 218, 2/7/12).

"We asked questions in the RFI about [lifetime income], and we got overwhelming responses from people who said, 'Yeah this is a great idea.' But when we asked the second set of questions, which is, 'So what should it look like?' We got lots of different ideas," Borzi said.

"That's what this exercise is about. It's about getting more comments in the form of a pre-regulatory proposal," she said.

The advance notice of proposed rulemaking will propose "alternative ways of how to illustrate lifetime income," Borzi said. The two main approaches DOL is contemplating are a snapshot of what a participant's current Section 401(k) balances would give that person at retirement and a projection of what a participant's balance would be when he or she reached retirement, Borzi said.

"That's our current goal, but I'm not sure what the timetable is, although hopefully we'll be able to get the ANPRM out soon," she said.

**Other Regulatory Priorities.** Aside from the fiduciary rule and lifetime income, DOL will focus on several regulatory priorities this year, including implementing more provisions of the Affordable Care Act, Borzi said.

DOL also hopes to finalize its amendments to its regulation on target date fund disclosure (227 PBD, 11/30/10; 37 BPR 2613, 12/7/10), Borzi said.

In addition, DOL recently issued proposed rules that seek to amend its regulation on abandoned plans to include plans of companies undergoing Chapter 7 liquidation under the U.S. Bankruptcy Code (237 PBD, 12/12/12; 39 BPR 2391, 12/18/12). Comments on the proposal are due by Feb. 11.

Borzi said she hopes the proposal "will be very, very helpful to people and will streamline and reduce costs in connection with winding up abandoned plans."

**DOL Enforcement.** On the enforcement front, Borzi said DOL will continue many of its ongoing projects, including its Consultant/Advisor Project (CAP) and its investigatory project targeting employee stock ownership plans.

"For a number of years, we've had a very active ESOP program. . . . The question of valuation of the stock in these ESOPs is always a problem, or frequently a problem. The valuation issues are a very important part of our enforcement program," Borzi said.

Under the CAP program, DOL scrutinizes under its investigatory microscope the fees, undisclosed compen-

sation, and conflicts of interest in the consultant/adviser market, Borzi said.

The electronic system for filing Form 5500s, EFAST2, has become a “a good enforcement tool, as well as a good way to broaden [EBSA’s] compliance assistance,” Borzi said.

EFAST2 gives DOL the opportunity to get back to Form 5500 filers quickly if it discovers an omission or irregularity, Borzi said. When filing problems are identified, the department can ask filers questions or tell them if necessary information was not included with the filing, she said.

**Participant Disclosures.** While many practitioners and groups declared DOL’s participant disclosure initiative under ERISA Section 404(a) a “nonevent” (218 PBD, 11/13/12; 39 BPR 2185, 11/20/12), Borzi said she thinks it is “way too premature for anybody to make any judgments.”

“The fact is that, by now, [participants] have probably gotten the basic sort of shopping-type information, and they’re just beginning to get their quarterly statements,” she said. “We didn’t expect the day after everybody got [the disclosures] that people would be pounding on the doors of their companies asking questions,” she said.

“My number-one bit of advice to people, and that’s what we do in our consumer outreach, is open the envelope,” Borzi said.

Borzi said she is thrilled that the disclosure project has sparked a national conversation and that people are becoming aware of the fees they are paying to their Section 401(k) plans.

“One of the major things we’ve been able to do is to make people focus on how much it costs to participate in a 401(k) plan, but don’t get me wrong, my advice is open the envelope, but my other advice is don’t let money sit on the table. If you work for an employer that offers a 401(k) plan, join it, contribute to it, get the match if the employer offers it,” Borzi said.

Borzi said she does not agree with the naysayers of the disclosure regime, calling it “an important success.”

But she said DOL’s work is not finished.

“There’s lots more work to do, and that’s what we’re going to be doing. One of the things that we are doing is continuing our outreach efforts both to employers and to participants so that they better understand the information that they’re getting,” she said.

“We wanted people to have better tools, and these are better tools. It’s not the be-all and end-all. It’s not the end of the story. There’s lots more of the story to be told, and we don’t think our work was done when we put out these regulations. We need to keep encouraging people . . . to look at this information and try to act on it and make better choices,” she said.

## PBGC Perspective

In 2013, the Pension Benefit Guaranty Corporation will “continue reforming [its] processes and procedures to make them more customer-friendly,” agency Director Joshua Gotbaum said.

“For example, last year, we found a way in our enforcement of the shutdown authorities [under ERISA Section] 4062(e) to focus on the companies and plans that were at greatest risk to PBGC and to not focus on

those companies and those plans that did not pose great risk to PBGC,” he said.

On Nov. 2, PBGC announced that it was changing its enforcement practices regarding Section 4062(e) enforcement and only focusing on companies for which there is a higher risk of default (213 PBD, 11/5/12; 39 BPR 2080, 11/6/12).

ERISA Section 4062(e) requires that, if a company ceases operations at a facility that results in 20 percent of employees who are plan participants losing their jobs, the company is treated as though it is subject to withdrawal liability on the termination of single-employer plans under multiple controlled groups (ERISA sections 4063 and 4064). Also, under Section 4065, the plan administrator must report this liability to PBGC.

Gotbaum said that, as a result of the change in the agency’s enforcement position, 92 percent of companies covered by PBGC would not be subject to enforcement under Section 4062(e).

“The business community has said for years to PBGC, ‘You should focus on circumstances where there is real risk,’ and we agree,” he said. Concentrating on real risk will allow the agency to focus its resources “where they matter,” Gotbaum said.

“One of the fundamental issues in pension regulation is that we tend to assume that everyone is likely to be a bad actor, that everyone is likely to undermine their employees,” Gotbaum said. “We tend to put in place regulations and protections that prevent that, but the issue is that those same protections to people who are not going to be bad actors simply become a hassle,” he said.

Gotbaum said it was important to reconsider PBGC’s enforcement of the statute because some “perfectly well-intentioned efforts to protect workers” result in “convincing many businesses that they shouldn’t offer employee benefits at all.”

“We think it’s important to do what the business community asked, which is to rethink where the real risks are, and that’s what we’re doing. That’s what we started with in 4062(e), and that’s what we’re going to do this year in other areas of our activity,” he said.

Gotbaum also said he is interested in modifying PBGC’s reportable events requirements and looking into simplifying and reforming PBGC’s payment schedules.

PBGC has a “pretty powerful incentive to do everything we can to make it as easy as possible for [companies] to offer pension plans to their employees,” Gotbaum said. “Because the fundamental issue is, if companies choose not to offer pension plans, PBGC goes out of business,” he said.

**PBGC Premiums.** The question of raising PBGC premiums will again be a big topic of discussion in 2013, practitioners said.

“I’m sure that PBGC will be raising concerns about issues relating to their premium structure. And I’m sure that employers will be stressing that they’ve already given on that particular issue and premiums have already been raised substantially,” ABC’s Dudley said.

Davis & Harman’s Mason called raising PBGC premiums “an enormous mistake” and said that increases would send a message to companies sponsoring defined benefit pension plans to leave the defined benefit system.

“If people leave the system, you’re going to have fewer premiums payers, and then you’re going to create a problem for the PBGC. So the higher they raise the premiums, the fewer companies are going to be in the system and the less premium income they’re going to get. So it’s almost exactly the wrong thing to be doing, but I think, unfortunately, it will be discussed,” Mason said.

PRC’s Friedman said that, although her group supported the premium increases included in MAP-21, it is not in favor of PBGC’s “setting their own premium structures.”

In July 2012, President Obama signed MAP-21, which included a provision that raised flat-rate insurance premiums for single-employer defined benefit pension plans by 40 percent over two years (126 PBD, 7/2/12; 39 BPR 1265, 7/3/12).

Although Gotbaum said he could not speak to whether Obama’s fiscal year 2014 budget would again include a proposal allowing PBGC’s board of directors the authority to adjust pension insurance premiums and to use a risk-based formula in doing so (29 PBD, 2/14/12; 39 BPR 342, 2/21/12), he said that PBGC premiums need to change.

“Whether or not there is a proposal in the budget, the fact is that PBGC premiums do need to be raised and reformed,” he said.

“The changes in MAP-21, in my view, were important changes on the funding relief side because it was very clear that there were companies and plans that were suffering because of the mandatory funding requirements. Congress recognized that, and so we think that’s a good thing,” Gotbaum said.

However, Gotbaum said that, by allowing plans more time “to meet their underfunding,” the risk to PBGC will go up, which is why he thinks Congress raised premiums in MAP-21.

Although Congress raised PBGC premiums, it did so in the “old scheme,” Gotbaum said, which penalizes companies that pose a small risk to PBGC.

“The existing scheme punishes low-risk companies. It punishes the good citizens. So, do PBGC premiums need to be raised? Yes, but I think they need as much to be reformed, because right now we’re in a world in which all the companies that sponsor defined benefit pension plans know that their premiums are being raised, not because they’re getting riskier, but because someone else mismanaged their business and terminated their pension,” he said.

**PBGC’s Financial Outlook.** Although PBGC will not run out of money anytime soon, the agency’s financial outlook has caused some concern in the retirement plan community. On Nov. 16, PBGC reported a \$34 billion deficit as of the end of fiscal year 2012, the largest shortfall in its history (222 PBD, 11/19/12; 39 BPR 2191, 11/20/12).

Regarding the agency’s finances, Gotbaum said that “PBGC’s finances are not sound long term. That doesn’t mean we’re going to run out of money this month, this year, or anything like that. But it is clear that, as you know in the world of pensions, if you wait until you’re on the verge of collapse, the remedies you have are extreme.”

“That’s why everything we do in the pension community is phased in over years, sometimes decades. My view is that PBGC pension reform should be phased in

over years for the same reason. Because if we don’t act soon and don’t phase it in, the options will be fewer and they will be more draconian,” he said.

**Spotlight on 4062(e).** While PBGC has pulled back on its enforcement of Section 4062(e), many in the retirement community still see Section 4062(e) enforcement as an issue to look out for in 2013.

ABC’s Dudley said her group has misgivings about PBGC’s enforcement on this front. “We still think they’re enforcing something that’s not spelled out in the statute. I think there will be more dialogue about that,” she said.

In 2010, PBGC proposed a rule on the application and enforcement of employer liabilities and reporting requirements under Section 4062(e) (152 PBD, 8/10/10; 37 BPR 1809, 8/17/10).

The 2010 proposed rule was met with a lot of push-back from employer groups, including the ERISA Industry Committee (220 PBD, 11/17/10; 37 BPR 2533, 11/23/10), ABC, the U.S. Chamber of Commerce, and the American Society of Pension Professionals and Actuaries (ASPPA) (198 PBD, 10/15/10; 37 BPR 2263, 10/19/10).

PBGC’s enforcement efforts surrounding Section 4062(e) sparked some controversy, and several employer groups wrote a letter to PBGC in December 2011 asking that it cease all enforcement actions that are based on the Section 4062(e) proposed regulations (246 PBD, 12/23/11; 39 BPR 6, 1/3/12).

**PBGC’s ‘Broad Authority.’** Mason said one question that remains regarding Section 4062(e) enforcement is how the agency is interpreting the statute.

“They interpreted it in some proposed regs issued in 2010 incredibly broadly,” he said. “They interpreted that statute to say you don’t have to shut down any facility—for example, if you just sell a facility, that’s a shutdown. They also interpreted it as saying that no one has to lose their job,” he said.

“So they’ve interpreted it so broadly . . . they put that in the proposed reg. The industry really expressed extreme concern over it to the point that they withdrew, but they keep enforcing the same rules. It’s not a good situation,” he said.

Mason said there is some concern about this issue on Capitol Hill but that he is not sure whether there will be any legislative movement on the issue this year.

“I think there will be a hard look at this because of the enormous problems it’s causing,” Mason said.

For his part, Gotbaum said PBGC’s view is that Section 4062(e) gives the agency “broad authority” to protect plans.

“The role of the PBGC is to preserve and protect plans, so we have to do it. What we’ve said is, within that broad authority, we will focus on those companies that are high risk,” Gotbaum said.

While PBGC has changed its enforcement stance, Gotbaum said the retirement plan community should not expect a re-proposal of the Section 4062(e) regulation anytime soon.

“Eventually, I’m told we’re going to have to. When I asked internally, I said, ‘Do we have to go through the entire regulatory process to make changes?’ [and] they said, ‘Formal changes in regulation, yes you must, but you have discretion as to how you enforce the law.’ . . . So we exercised our discretion to pay attention to risk,” he said.

**'Fresh Look' at Multiemployer Plans.** PBGC will address the issue of multiemployer plans in the near future, Gotbaum said. PBGC's director recently said the agency should give its multiemployer program a "fresh look," because the program has not been substantively changed in more than 30 years (243 PBD, 12/20/12; 40 BPR 8, 1/1/13).

"The PBGC multiemployer program ought to be revisited because our multiemployer program is very different from our single-employer program. Its benefits are lower, we have fewer tools, and we have much fewer financial resources. So on multiemployer plans, all too often, PBGC can do nothing except wait for plans to run out of money," Gotbaum said.

"Until that point, PBGC can't say, 'Are you conserving your cash? Are you watching your expenses? What are you doing about the authorities you have to adjust benefits?' We don't do any of that. So . . . absent changes, [the program] will eventually run out of money. Our view of it is, the next year to two is the right time to rethink that," he said.

Gotbaum said he would like to see the agency have more tools to help multiemployer plans before they get into trouble, tools that currently do not exist. He said he would like PBGC to be able to get more up-to-date information on multiemployer plans, as well as "have the ability to talk with them before they run out of money."

He said that, "in the single-employer system, we have 4062(e) . . . we have reportable events. We can threaten to take over a plan, and can and do take over plans when we think they are in distress and in trouble. In the multiemployer system, we can't take over a plan even after it's run out of money. After a Taft-Hartley plan runs out of money, the operators stay in place, and we mail them checks."

## Congressional Uncertainty

Employee benefit practitioners are united in their uncertainty about how Congress will deal with sequestration, the automatic budget cuts enacted as part of the Budget Control Act of 2011. Not knowing how federal lawmakers will handle the debt ceiling crisis has added to the uncertainty, practitioners said.

Kathryn L. Ricard, the ERISA Industry Committee's senior vice president for retirement policy, said ERIC is "very conscious that [retirement benefits] could be looked at as a revenue source, whether it is changing the limits or changing some of the rules associated with 401(k) plans."

Reducing the tax code Section 402(g) limits on tax-deferred income is one way that Congress might seek to generate revenue, Ricard said. Another might be to use means-testing to limit the value of tax deductions and tax exclusions for high-income households, which would create an administrative challenge for employers, she said.

"If you start phasing out the ability of someone to participate based on income, that's a very difficult thing for an employer to get a handle on," Ricard said. Employers know what they pay an employee, she said, but "they're not in a position to know other income that that person receives."

A congressional fight over spending cuts and raising the federal debt limit will occur fairly quickly, Ricard said, as the nation is expected to break through the debt ceiling by the end of February and sequestration is set

to take effect March 1. Comprehensive tax reform, still a question mark, will take longer, and nobody yet knows whether tax code changes would stand alone or be folded into legislation on sequestration or the debt ceiling, she said.

With all of the uncertainty, practitioners are focused primarily on preventing deep cuts in tax incentives for workplace pensions and retirement savings plans, said Judy A. Miller, chief of actuarial issues and director of retirement policy at ASPPA.

"That's the main thing we're looking [at] this year," Miller said.

**Pension Funding Relief.** Congress may enact another pension funding relief measure in 2013 to help defined benefit plan sponsors that will see the impact of recently enacted interest rate changes begin to phase out a couple of years from now.

By reducing the mandatory pension funding obligations of employers that sponsor defined benefit plans, Miller said, a funding relief measure could satisfy lawmakers' desire for additional tax revenue to offset tax cuts or reduce deficit spending, Miller said. That is because cash that a plan sponsor is not required to contribute to a tax-deferred pension trust is taxed at the plan sponsor's normal income-tax rate.

MAP-21 authorized Treasury and IRS to provide 25-year average segment rates and adjusted 24-month average segment rates for single-employer defined benefit plan sponsors to use for calculating their minimum funding obligations (159 PBD, 8/17/12; 39 BPR 1574, 8/21/12).

With interest rates expected to remain low for several more years, Congress might be receptive to modifying the formula in the pension funding relief provisions in MAP-21, Miller said.

Davis & Harman's Mason agreed that pension funding stabilization will be big in 2013.

"What was done in 2012 was wonderful, but it wears out. It phases out. So it's good for 2012 and it's excellent for 2012 and it's still good for 2013. Starting in 2014, it's not very helpful. And starting in 2015, it's not helpful at all," he said.

Companies are already planning for 2014, Mason said, which means plans are already further into the future when it comes to thinking about funding their plans. Mason said that, if something is not done about funding stabilization in 2013, employers might find it necessary to cut jobs.

"If we don't act to extend this in 2013, we will see more jobs lost because of funding problems. We will see them; it's not speculation. There will be more jobs lost if we don't get more funding stabilization within the next 12 to 15 months," he said.

Mason said he is not sure whether Congress will address the issue in 2013 but that he hopes lawmakers will make the issue a priority.

"I've talked to people on the Hill who've said to me that they know that this is an issue that has to be addressed, but they have not been talking about timing at all. So whether it'll be '13, I don't know. I very much hope it's '13. It needs to be '13," Mason said.

Miller was confident in predicting that, in 2013, Congress will enact funding legislation for multiemployer plans.

"I would put a high likelihood on that," Miller said.

Funding relief rules established for underfunded multiemployer plans by the Pension Protection Act of 2006 will expire at the end of 2014 (225 PBD, 11/26/12; 39 BPR 2246, 11/27/12). Specifically, the statute's funding rules for underfunded plans whose status is "endangered" or "critical" are scheduled to sunset Dec. 31, 2014.

**Comprehensive Tax Reform** A comprehensive tax reform bill could create opportunities for making bipartisan retirement policy improvements, but whether Congress would attach retirement provisions would depend on how acrimonious deliberations become, said Robert M. Richter, immediate past president of ASPPA and vice president at SunGard Relius in Jacksonville, Fla.

"During that tax reform discussion, I think there will be a desire to really question almost all tax expenditures, including the favorable treatment of retirement plans and IRAs, Mason said.

PRC's Friedman agreed that tax reform will be a top issue this year and said "there's no question that Congress is going to look at the tax subsidies that are now going to retirement plans."

"That's one issue that's definitely going to be front and center because I think the tax debate is kind of an overarching theme for all other pension and retirement issues," Friedman said.

Contributions and earnings on contributions to Section 401(k) and other defined contribution plans will cost the Treasury an estimated \$375.9 billion in deferred tax revenue for fiscal years 2011 through 2015, according to January 2012 estimates by the congressional Joint Committee on Taxation.

Uncollected tax revenue from defined benefit plan contributions and related earnings will total about \$263.7 billion during the same five-year period, JCT found.

**Expanded Coverage.** Practitioners said they are not optimistic that federal lawmakers will pass legislation in 2013 to expand the number of private-sector workers covered by a workplace retirement savings or pension plan.

"If you're young, if you're a minority, if you're a woman, if you're single, if you're low-income, if you don't work a lot of hours, if you're part time, you really have major, major problems when it comes to retirement security," said Diane Oakley, executive director of the National Institute on Retirement Security.

Some people are beginning to ask whether ERISA, which is the foundation of private-sector retirement income security, might be part of the problem, Oakley said.

Small employers complain that they lack the resources necessary to satisfy all of the legal requirements of ERISA and often express interest in having another entity "assume the fiduciary duties," she said.

Oakley asked: "Is ERISA holding us back from getting coverage for the people who don't have it today?"

She said that question might be answered at the state level, pointing to the example of California, where a new law (190 PBD, 10/2/12; 39 BPR 1901, 10/9/12) authorizes the state to consider developing a private-sector plan based on automatic payroll deduction individual retirement accounts. Participation would be mandatory for employers that offer their employees no other retirement plan options.

"There is going to be more interest in states across the country in saying, 'What did California do, and should we be starting to do something?'" Oakley said.

The California proposal is contingent on the state's receiving IRS's approval that the plan would operate like an IRA and would not be subject to regulation under ERISA.

**Benefit Innovations.** Practitioners also do not expect 2013 to be a year for dramatic innovation in retirement plan benefits. However, innovation is always possible when Congress tackles tax reform, Miller said.

"I haven't heard any Hill staff talking about this, but among the retirement community, I think there would be interest in making the DB(k) concept something meaningful," Miller said.

A DB(k) plan, described under tax code Section 414(x), is a combined defined benefit and defined contribution plan with assets held in a common trust.

"What if you could make matching contributions to cash balance plans instead of putting them into a 401(k)? That, I think, has interesting possibilities," Miller said.

However, whether meaningful innovations are possible is an unanswered question at this point, Miller said. "Whether there will be an opportunity to really delve into some of these things, or [whether] we end up with just a quick revenue exercise and then we're done with it, we don't really know," she said, referring to changes in deferral limits that would generate immediate tax revenue.

Treasury and IRS listed DB(k) regulations under tax code Section 414(x) in its 2012-13 Priority Guidance Plan (223 PBD, 11/20/12; 39 BPR 2245, 11/27/12).

"It's possible that, if guidance were to come out, giving us more details on those rules, that type of plan might become more popular," Richter said.

He also said any legislation that expanded the use of electronic disclosure almost certainly would lead to innovations in employer communications with plan participants.

"Aside from just the obvious cost-savings to plans and ultimately participants, there can be more creative ways of educating participants, encouraging them to save, [and] having tools to available to them to better predict what their retirement savings should be," Richter said.

**Plan Security and Portability.** Many practitioners are waiting to see a major legislative proposal from Sen. Tom Harkin (D-Iowa), chairman of the Senate Health, Education, Labor and Pensions Committee, that would address retirement income insecurity. Harkin has said he intends to introduce pension legislation in 2013 (145 PBD, 7/30/12; 39 BPR 1437, 7/31/12).

Harkin described the initial proposal, Universal, Secure and Adaptable (USA) Retirement Funds, as "a middle ground between pensions and 401(k)s." A board of trustees representing employers, employees, and retirees would oversee each USA Retirement Fund.

In contrast to retirement savings in today's Section 401(k) plans, contributions to USA Retirement Funds would be pooled and managed professionally. Participants would receive their benefits as monthly retirement income.

Like today's Section 401(k) plan accounts, individual accounts under Harkin's hybrid pension proposal would be "portable" from one employer to another. Un-

like Section 401(k) plans, the proposed USA Retirement Funds would expose employers to no fiduciary risk and to very minimal investment or market risk, Harkin said when he introduced the proposal.

"We are currently talking to experts and stakeholders about how to make this proposal work, and we are hopeful that this can be a bipartisan issue in the 113th Congress," a HELP committee aide said.

## Delayed Regulations

Retirement plan practitioners hope and expect that 2013 will be the year that Treasury and IRS release final regulations on cash balance and other hybrid plans. Practitioners also expect to see a final regulation on minimum required contributions to single-employer defined benefit plans.

Treasury and IRS listed both items in their 2012-2013 Priority Guidance Plan document as final regulations relating to hybrid plans under tax code sections 411(a)(13) and 411(b)(5) and final regulations on determining minimum required contributions to fund defined benefit plans under tax code Section 430.

Actuaries have been "trying to do something that's reasonable in the absence of specific guidance, but we've been looking forward to seeing it for quite a while," Miller said about the final regulation on minimum required contributions. Treasury and IRS proposed the regulation on minimum required contributions in 2008 (71 PBD, 4/14/08; 35 BPR 833, 4/15/08).

"The other thing that we're all very much looking forward to are hybrid regs," Miller said. Treasury and IRS proposed regulations on hybrid plans in 2010 (200 PBD, 10/19/10; 37 BPR 2306, 10/26/10).

"My understanding is the minimum required contribution regs will come before the hybrid regs," Miller said, adding that she expects to see both in 2013.

Many employers and practitioners are hopeful that cash balance plans are the new generation of defined benefit plans, "so quite frankly, the delay has not been helpful in that regard," Ricard said.

"The uncertainty surrounding these plans in terms of how you administer them has had a chilling effect on [whether] to start them or convert to them," she said. "Depending on what the regs say," she added, "we're hopeful that we'll see more plans, midsize and large plans, taking them up."

Treasury and IRS are working on a separate but related regulatory project on pension equity plans. "It's unclear whether we'll see proposed regulations this year, but we know they're working hard on that," Ricard said.

**Interim Amendments.** Practitioners have been expecting Treasury and IRS to change some of the administrative procedures that employers must follow for adopting interim amendments, but one practitioner puts the odds at 50-50 that changes will be published in 2013.

The Treasury and IRS priority guidance plan indicates that a new revenue procedure under tax code sections 401(a) and 403(a) is a priority item for 2013. Richter, however, said he has some doubts about whether Treasury and IRS this year will update interim amendment procedures in Revenue Procedure 2007-44.

Richter said policy differences within Treasury could further delay the revenue procedure. "I know there's disagreement internally" about how to change the in-

terim amendment procedures, he said. Interim amendments have been a major source of practitioner complaints (26 PBD, 2/8/11; 38 BPR 314, 2/15/11).

"I'd say there's a 50-50 chance of that [revenue procedure] being out this year," Richter said.

"My fear," he added, "is that they may do something that ultimately makes it worse."

**Regulatory Enforcement of 403(b) Plans.** Robert J. Toth Jr. of the Law Offices of Robert J. Toth Jr. in Fort Wayne, Ind., said he does not expect many new regulatory initiatives related to retirement plans in 2013, especially with respect to plans regulated under tax code Section 403(b).

Treasury and IRS issued a final regulation on 403(b) plans in 2007 (141 PBD, 7/24/07; 34 BPR 1777, 7/31/07).

"You're going to see more of a focus on finally enforcing compliance," not only with rules under 403(b), but also with recent disclosure regulations from DOL, Toth said.

"You're going to see much less grace," he said. "You're going to see the start of 'let's get on with it.'"

## Pension 'De-Risking'

The trend of "de-risking" pension plans and the overall ramifications of some de-risking strategies is another issue that could get a lot of attention in 2013, practitioners said. In 2012, Ford Motor Co. and General Motors Co. announced that they would offer some retired and former employees a one-time opportunity to take lump-sum distributions, and pension rights advocates were surprised at how quickly other large employers appeared to follow suit (212 PBD, 11/2/12; 39 BPR 2077, 11/6/12).

For some companies, such as GM and Verizon Communications Inc., de-risking strategies have included buying a group annuity contract to transfer pension obligations to private insurers.

Friedman of PRC said that "more companies are now selling off their pension plans to insurance companies, or after people have retired, offering them lump-sum benefits to get those liabilities off the books."

"That is something that lots of companies have taken advantage of, this new de-risking strategy, but it's unclear how it's affecting participants. So there needs to be an examination of that issue. We're pretty sure that will come up this year," she said.

PRC called for a "moratorium" on such de-risking strategies until their impact on participants can be assessed, Friedman said.

"These are people at the most vulnerable point in their life where they think that they're all set. Their pensions are guaranteed [and] they're going to continue to get them for the rest of their lives," she said. Then they are told they will either have their annuity paid by an insurance company or that they have to take the remainder of their pension as a lump sum, she said.

Friedman said Congress will need to examine several issues, including whether companies should be allowed to offer lump sums to participants after retirement.

**Contributing Factors.** The Obama administration proposal that would allow PBGC to set its own premiums is one factor that might have sparked the de-risking trend, Davis & Harman's Mason said.

“People sort of said, if premiums are going to go way up, maybe we should explore taking people out of the plan because that avoids this huge new premium,” Mason said. He added that the proposal alone was not the “main driver” behind the trend but that the possibility of higher premiums definitely added fuel to the fire.

Mason also attributed the de-risking trend to the funding stabilization included in MAP-21 and the need for “accounting stabilization.”

“Accounting volatility and funding volatility are the two main drivers of de-risking, but the catalyst that got people thinking about it was the administration’s proposal to raise premiums,” Mason said.

Mason said there is a lot of concern regarding de-risking on the Hill and the government, but he is not sure whether there will be any legislative or regulatory action on it in 2013.

Solving issues with premiums, funding, and accounting are “the best way to address the de-risking question. You take away the things that drove people to do this,” Mason said.

**Fiduciary Intersection.** Friedman said the fiduciary rule dovetails nicely with the recent trend of pension de-risking.

“If [de-risking] continues, you have companies that are essentially telling people that they can take their pension as a lump sum. So suddenly retirees . . . [are] going to have their pensions turned into . . . these huge pots of money that they’ve never seen before,” she said. “Then they’re going to be vulnerable to a lot of vultures out there. So, in that situation, then brokers really should be acting solely in the interest of participants,” she said.

DOL’s Borzi offered her take on the de-risking trend, calling it “worrisome” and saying the trend “certainly flies in the face of [DOL’s] push toward expanding lifetime income.”

Borzi echoed Friedman’s comments about the intersection of de-risking and the fiduciary rule, saying the two are tied because the companies that are de-risking their pension plans are hiring people to advise plan participants.

“We’ve been told that none of these people are to be considered fiduciaries, and so we worry about those things, but I don’t know whether the administration will have a position on it or do anything,” Borzi said. She added that her concerns on the issue are about “making sure that people get unbiased information so that they can make the choice that’s best for them.”

PBGC’s Gotbaum said it is “entirely understandable that businesses want to reduce the volatility of the obligations they undertake in offering pensions to their employees” but that there are better and worse ways to minimize pension plan risks.

“I think that de-risking your pension plan by dumping all your pension obligations in a lump sum on your employees does a disservice to those employees, even if it’s voluntary,” he said, because many employees will not have the expertise to manage those lump sums.

“From our perspective, de-risking that involves the purchase of annuities, duration-matching in your portfolios, those are infinitely preferable to de-risking by dumping your pension obligations in a lump sum on your employees,” Gotbaum said.

## In-Plan Roth Transfers

Practitioners are looking to Treasury and IRS for speedy guidance on liberalized rules for in-plan transfers to Roth accounts, which Congress included in fiscal cliff legislation enacted into law Jan. 2 (2 PBD, 1/3/13; 40 BPR 62, 1/8/13).

The statutory language in the American Taxpayer Relief Act of 2012 is bare bones, Toth said. “We will need guidance,” he said.

The short-term budgetary consequences of the Roth provision are positive, but the long-term consequences are “actually kind of scary,” Toth said.

Budget estimates show that the Roth provision will generate \$12.2 billion in tax revenue inside a 10-year budget window. But Toth said that “somebody is going to regret that provision because, based on our experience with the original Roth provisions, when you start running the numbers for the out-years, we should expect it to be a serious revenue-loser,” he said.

Under the tax code’s Roth rules, income is taxed before it can be transferred to a Roth retirement savings account, and all earnings and distributions from those accounts are untaxed.

A decision to offer the new Roth option will not be easy for employers to make, ERIC’s Ricard said.

“Not all employers have Roth 401(k)s because that’s one more type of benefit to explain,” she said.

“You start skating very close to providing tax advice [when] you’re talking about the tax implications of a Roth versus a traditional” account, Ricard added.

## Executive Compensation

Public companies are heading into their third year of say-on-pay, mandated by the Dodd-Frank Wall Street Reform and Consumer Protection Act. Another requirement under the act—that the Securities and Exchange Commission adopt rules requiring issuers to develop and implement a clawback policy—is pending. Both issues are among those that figure large in company concerns, said Mary J. Mullany, a partner in the Philadelphia office of Ballard Spahr. While companies are spending a great deal of time on corporate governance issues, they must also focus on tax law changes that directly affect executive pay.

**Tax Climate for Deferred Compensation Plans.** One of the assumptions in favor of deferred compensation is that an executive’s tax rate at the time of payment—most likely retirement—will be lower than the executive’s current tax rate. The increases in tax rates effective in 2013 for high-income taxpayers help make the case for deferred compensation (9 PBD, 1/14/13; 40 BPR 148, 1/15/13).

According to Daniel L. Hogans, a partner in the Washington office of Morgan Lewis, increases in the rates on ordinary income and capital gains, together with the additional surcharge on unearned income, may cause employers and executives to reconsider their pay structures “in favor of relatively more deferral and for longer periods.”

Hogans said in an email that, “with long-term capital gains rates increasing to 23.8 percent (including the 3.8 percent surtax on unearned income) from 15 percent, the potential tax advantage to investment gains on non-



deferred (after tax) amounts is significantly diminished.”

Beginning in 2013, under the Affordable Care Act, high-income earners will pay an additional 3.8 percent Medicare tax on net investment income.

“Coupled with the increase in ordinary income rates at higher income levels, the tax treatment of deferred compensation, particularly amounts paid over time after retirement when such amounts could be taxed at lower rates, becomes a good deal more attractive to executives affected by combined state and federal marginal tax rates that can exceed 50 percent on current compensation,” Hogans said.

**Say-on-Pay Votes.** Getting very high levels of support for a company’s shareholder advisory vote on compensation of the named executive officers remains a high priority for public companies. In 2012, a number of companies received shareholder support at less than the 85 percent to 90 percent level, Mullany said. While some levels of support might be sufficient for a company to have passed a say-on-pay vote, they are not sufficient for purposes of getting a good score for a company’s executive pay practices from proxy advisers such as Institutional Shareholder Services Inc. and Glass Lewis & Co. or to meet guidelines of many institutional shareholders, she said. In the world of say-on-pay, “80 percent has become the new 51 percent,” she said.

Improving a company’s score and its chances of receiving a very high level of support for its executive pay program goes hand-in-hand with good pay practices, she said. At the same time, proxy advisers and institutional investors continue to push for the elimination of problematic pay practices, such as payment of tax gross-ups on compensation triggered by a change in control, she said.

**Losing Vote to Litigation.** Companies have found that losing a say-on-pay vote can lead to litigation. Failed say-on-pay proposals in 2011 and 2012 touched off a spate of shareholder derivative actions that, for the most part, were unsuccessful (see, for example, 9 PBD, 1/17/12; 39 BPR 163, 1/24/12). However, Laura G. Thatcher, a partner in the Atlanta office of Alston & Bird, said “they have been followed by a more disturbing spate of lawsuits seeking to enjoin the annual meeting on the basis that the proxy statement does not provide sufficient information for the shareholders to make an informed voting decision on the say-on-pay proposal or an equity plan proposal.”

The threat of an injunction to delay the annual meeting posed by these lawsuits “gives the plaintiffs leverage to force a quick settlement,” Thatcher said. She added that, “while these suits are in most cases without merit, they are distracting and costly to deal with.”

Regarding the effect of this second type of lawsuit on equity plan proposals, Thatcher said in an email that, “because an equity plan proposal seems to be a lightning rod for these types of suits (presumably because the plaintiff has the company over a barrel if the equity plan is running out of shares for future equity grants), the specter of being targeted for suit is making some companies think twice about whether 2013 is the best year to seek shareholder approval for a new equity plan (or reloading an existing plan with additional shares) if they don’t really need more shares immediately.”

Section 955 of Dodd-Frank requires issuers to disclose any policy that allows any employee or director to hedge against any decrease in value of equity-based awards granted as part of compensation.

While Dodd-Frank is concerned with hedging, ISS has recently focused on “pledging” of shares as “a seriously problematic pay practice,” Thatcher said. Companies that have acted to prohibit hedging in anticipation of SEC rules “now may be inclined to revisit those policies and consider whether and how to regulate, monitor, or prohibit pledging of company shares,” she said.

**Clawback Policies.** Section 954 of Dodd-Frank requires SEC to promulgate rules to guide issuers in the development of clawback policies to recover incentive-based compensation from executives if certain future triggering events occur. The Dodd-Frank clawback provision is “a very difficult provision to wrap your hands around,” Mullany said.

Compared with the Sarbanes-Oxley Act of 2002, which generally applies to chief executive officers and chief financial officers and is generally fault-based, the Dodd-Frank clawback provision aims “at a broader class of officers and will require more regulatory guidance,” she said.

Mullany said that she has counseled clients to put protective language in place in both equity- and cash-based plans. Thus, some companies are not waiting for SEC to adopt a rule but are stating in their plans that they will comply with regulations directed at clawback activities as required by Dodd-Frank, she said.

**Trading Plans.** Insider trading and its impact on executives is another top issue. Mullany cited growing criticism of 10b5-1 trading plans. Rule 10b5-1 trading plans allow corporate insiders to trade in their companies’ securities without violating the Securities Exchange Act of 1934. Adopted by SEC in 2000, Rule 10b5-1 provides a safe harbor for executives to make trades in employer securities.

Concern about this issue is felt at the executive level, Mullany said, noting that it is the executives who are managing their investment portfolios and who will eventually seek to monetize their equity compensation. Articles in the financial media in November and December and earlier academic studies found that the use of trading plans “don’t quite get you there” in preventing insider trading concerns, Mullany said (2 PBD, 1/3/13; 40 BPR 69, 1/8/13).

Mullany said she expects SEC will look at the trading plan safe harbor rules this year, but action on this and outstanding Dodd-Frank issues will probably take a back seat to the agency’s rulemaking obligations under the Jumpstart Our Business Startups Act, enacted in 2012 to relax securities reporting and registration requirements with the aim of easing capital formation.

**Section 162(m) Litigation.** Shareholders are also bringing derivative actions against corporate directors for corporate waste and breach of duty of loyalty in cases in which the company pays compensation that is nondeductible under tax code Section 162(m), Thatcher said (168 PBD, 8/30/12; 39 BPR 1690, 9/4/12). The Section 162(m) cases “focus not so much on the amount of compensation (as in the say-on-pay suits) as on the process for determining pay,” she said in an email.

The 162(m) complaints take a “see what sticks” approach and generally have two themes, Thatcher said.

First, plaintiff shareholders have sued directors for “corporate waste” and “breach of duty of loyalty” in cases in which the company pays compensation that is nondeductible. Plaintiffs have espoused the theory that there is somehow a “fiduciary duty to minimize taxes,” Thatcher said. She said that “this entirely novel position has been rejected by the Delaware Chancery Court.” The Chancery Court’s decision was upheld by the Delaware Supreme Court on Jan. 14 (13 PBD, 1/18/13).

Second, some lawsuits claim that a proxy statement contained false and misleading indications that compensation would qualify as tax-deductible, performance-based compensation when, according to

the plaintiffs, the awards were too subjective or otherwise would not qualify under Section 162(m). It follows, plaintiffs allege, that this false representation represents a breach of loyalty and lack of good faith.

Thatcher said the second theory “is prompting companies to be very careful in the way they word their proxy disclosures.” They are avoiding affirmative statements in the compensation discussion and analysis that “certain elements of compensation ‘will be deductible’ under 162(m), in favor of more flexible language such as ‘is intended to be deductible’ or ‘may be’ deductible, and making it clear that the compensation committee may choose to grant compensation that does not qualify as deductible performance-based compensation.”

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