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Insider

The CARES Act: Health and benefit implications for plan sponsors

By Ann Marie Breheny, Anu Gogna and Ben Lupin

On March 27, President Trump signed into law the **Coronavirus Aid, Relief, and Economic Security (CARES) Act**, which provides changes for employer-sponsored group health plans and other benefit programs in response to the COVID-19 pandemic. Provisions include an expanded temporary safe harbor allowing high-deductible health plans (HDHPs) to provide first-dollar coverage for telehealth services for all conditions, not just COVID-19; expanded coverage of COVID-19 testing and clarification on the cost to plans for testing at non-network providers; expedited coverage of COVID-19 preventive services and vaccines; changes to the items reimbursable by health savings accounts (HSAs), health reimbursement arrangements (HRAs) and health flexible spending accounts (FSAs); and changes to the previously passed COVID-19 testing mandate and emergency paid leave provisions.

In This Issue

1 The CARES Act: Health and benefit implications for plan sponsors
3 Departments issue FAQs on implementation of FFCRA and CARES Act
5 California court addresses unlimited PTO policies
6 PBGC fine-tunes regulations to improve effectiveness and clarity
9 House proposes annual disclosure of human capital metrics
11 WTW Pension 100: Year-end 2019 disclosures of funding, discount rates, asset allocations and contributions

Group health plan provisions

- **Telehealth and HDHPs.** The CARES Act provides a safe harbor to allow HSA-qualifying HDHPs to provide telehealth or other remote health care services for all conditions (not just COVID-19) with no deductible or with a deductible that is lower than the applicable HDHP deductible.[1] Such services can be offered without risking HSA eligibility. Providing telehealth without cost-sharing in non-HDHPs has never been an issue and may continue.

  The safe harbor remains in effect until the end of the 2021 plan year (i.e., for a calendar-year plan, it applies for the 2020 and 2021 plan years). This change will require plan document/summary plan description (SPD) amendments and carrier contract updates.

- **Coverage of COVID-19 vaccine and preventive services.** Under the CARES Act, group health plans and health insurance issuers must cover, without cost-sharing, "qualifying coronavirus preventive services" — i.e., items, services and immunizations intended to prevent or mitigate COVID-19 that receive an "A" or "B" rating from the United States Preventive Services Task Force or a recommendation from the Advisory Committee on Immunization Practices of the Centers for Disease Control and Prevention (CDC) with respect to the patient involved. This requirement will apply 15 business days after the recommendation is made (normally more than a one-year process).

  Plan amendments are unlikely to be necessary because plan documents and SPDs typically do not include a full list of preventive services. Further guidance on how individual-by-individual CDC recommendations will work in practice will likely be necessary.

- **Expansion of coverage for COVID-19 testing.** Under the Families First Coronavirus Response Act (FFCRA),[2] which took effect on March 18, all group health plans must cover Food and Drug Administration-approved testing to detect

[1] This extends the rule established in **IRS Notice 2020-15** to offer telehealth *for any reason,* not just treatment of COVID-19. See "**IRS guidance on first-dollar coverage for COVID-19 testing and treatment**," *Insider*, March 2020.

[2] See "**Mandatory coverage of COVID-19 testing and small employer paid leave signed into law**," *Insider*, March 2020.

or diagnose COVID-19 and the administration of that testing without cost sharing or barriers. The coverage includes any services or items provided during a medical visit – including an in-person or telehealth visit to a doctor's office, an urgent care center or an emergency room – that result in and are directly related to the coronavirus testing or screening. The CARES Act broadens the testing to include tests provided by labs on an emergency basis, state-developed tests and any other tests determined appropriate by the Department of Health and Human Services (HHS). For COVID-19-related testing at in-network providers, plans will pay the negotiated rate. For testing provided at non-network providers, plans will be required to pay the "cash price" listed on the provider's website unless the plan negotiates another rate. The CARES Act does not address whether a participant could be subject to balance billing even after the plan has made payment to a non-network provider.

Employers will need to communicate the availability of COVID-19 testing to their plan participants. Formal amendments to plan documents/SPDs will need to be made in accordance with ERISA rules (which generally allow the documents to be updated seven months after the end of the year in which the change is made). Note: The testing coverage requirements adopted under FFCRA and amended by the CARES Act apply *only* while there is a declared public health emergency.

- **Over-the-counter (OTC) medical products without prescription:** The CARES Act allows account-based plans, including HSAs, FSAs and HRAs, to reimburse individuals for the purchase of OTC medical products, including menstrual products, without a prescription from a physician.

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The testing coverage requirements...apply only while there is a declared public health emergency.

This eliminates the Affordable Care Act requirement limiting the use of spending accounts to *prescribed* medicines or drugs (with the exception for insulin).

Employers will want to work with their third-party administrators and vendors to make these changes to reimbursement systems as soon as possible.

COVID-19 emergency paid leave

The CARES Act provides some clarifications to the emergency paid leave programs enacted as part of the FFCRA, such as giving an employee who was laid off by an employer on March 1, 2020, or later access to paid family and medical leave in certain instances if he or she is rehired by the employer. The CARES Act also corrects a drafting error in the FFCRA to confirm that the $200/day and $10,000/ aggregate paid leave maximums for employers subject to the emergency Family and Medical Leave Act (FMLA) provisions, and the $200/$511/day and $2,000/$5,110 aggregate limits for employers subject to the emergency paid sick leave requirements, apply *per* employee taking leave.

The emergency paid sick leave and emergency FMLA leave provisions continue to apply only to private-sector employers with fewer than 500 employees. The Department of Labor (DOL) has developed a **webpage** and **FAQs** on emergency paid leave (including how to determine whether an employer is a "covered employer").

Student loan repayment assistance

The CARES Act amends the tax code pertaining to educational assistance programs. Between March 27, 2020, (the CARES Act's enactment date) and December 31, 2020, employer payments of principal or interest on any employee qualified education loan will not be included in the employee's gross income. The total amount that can be provided under an educational assistance program, including student loan repayments for the temporary period, remains capped at $5,250 per calendar year per employee.

Any employer wanting to take advantage of these provisions must have a written educational reimbursement program in place amended to include student loan repayment during the *temporary period*.

Further guidance required

Certain provisions have no immediate implications for employers but will require additional government guidance:

- **HIPAA and PHI.** The CARES Act requires HHS to issue guidance on sharing patients' Health Insurance Portability and Accountability Act (HIPAA)-covered protected health information (PHI) during the COVID-19 public health and national emergencies. The guidance is to be issued within 180 days of the act's enactment (i.e., March 27) and will include information on how to comply with HIPAA regulations and any policies that become effective during these emergencies.
- **Confidentiality and disclosure of records relating to substance use disorder.** Under the CARES Act, once a patient at a federally subsidized substance use disorder treatment center gives written consent, HIPAA-covered entities and business associates may use and disclose information relating to that patient in accordance with HIPAA rules. This provision may relieve HIPAA-covered entities, including health plans and many health care providers, from the need to meet additional notice and confidentiality requirements that took effect earlier this year.[3]
- **Expansion of DOL authority to postpone certain deadlines.** The CARES Act amends ERISA by adding "public health emergency" to the circumstances under which the DOL may postpone an ERISA filing deadline for up to one year. The law does not address specific filings, such as the Form 5500, which will likely be part of forthcoming DOL guidance. The CARES Act does not give authority to the IRS, Treasury or HHS to postpone their deadlines, but the employer community has requested deadline relief from those agencies.

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[3] See "**Substance use disorder confidentiality rules may impact contracts**," *Insider*, March 2020.

Departments issue FAQs on implementation of FFCRA and CARES Act

By Maureen Gammon and Anu Gogna

The Departments of Labor, Health and Human Services, and Treasury have issued **FAQ guidance** on implementation of the Families First Coronavirus Response Act (FFCRA) and the Coronavirus Aid, Relief, and Economic Security (CARES) Act. The FAQs also clarify other COVID-19-related health coverage issues, including excepted benefits, telehealth and other remote care services. The guidance is effective immediately.

The FFCRA, as amended by the CARES Act, requires group health plans to provide first-dollar coverage for COVID-19 testing and related medical office, urgent care and emergency room costs, lasting through the public health emergency period.[1] The departments note that their implementation approach focuses on assisting (rather than penalizing) group health plans, health insurance issuers and others that are working in good faith to comply with the FFCRA and CARES Act.

FFCRA and CARES Act

The FAQs include the following clarifications on the COVID-19 testing mandate provisions in the FFCRA and CARES Act:

- **Plans subject to the testing mandate.** The COVID-19 testing mandate applies to group health plans and health insurance issuers offering group or individual health insurance coverage (including grandfathered health plans). This includes ERISA plans, non-federal governmental plans (such as plans sponsored by states and local governments), and church plans. Not included are short-term limited-duration insurance, excepted benefits and retiree-only plans.
- **Effective date of testing mandate.** Plans will be required to provide benefits for certain items and services related to diagnostic testing for COVID-19 beginning on or after March 18, 2020, and during the applicable emergency period.

The FAQs also clarify other COVID-19-related health coverage issues, including excepted benefits, telehealth and other remote care services.

[1] See "**Mandatory coverage of COVID-19 testing and small employer paid leave signed into law**," *Insider*, March 2020; and "**The CARES Act: Health and benefit implications for plan sponsors**," *Insider*, April 2020.

- **Items and services required to be covered.** Plans are required to cover 1) in vitro diagnostic tests (including serological tests); and 2) items and services furnished to an individual during a health care provider office visit (including in-person and telehealth visits), urgent care center visits and emergency room visits that result in an order for or administration of an in vitro diagnostic test.

  In addition, any items and services furnished during visits (including in-person and telehealth) that result in an order for or administration of a COVID-19 diagnostic test must be covered to the extent they relate to the furnishing or administration of the test, or help a health care provider determine the need for such a test. For example, if a provider determines that a blood test and influenza test are necessary to assess the need for COVID-19 diagnostic testing, and the visit results in an order for or administration of COVID-19 diagnostic testing, the blood and influenza tests must be covered.

The items and services discussed above must be provided without cost sharing (including deductibles, copayments and coinsurance), prior authorization or other medical management requirements.

- **Cost sharing, prior authorization and medical management requirements.** The items and services discussed above must be provided without cost sharing (including deductibles, copayments and coinsurance), prior authorization or other medical management requirements.
- **COVID-19 testing at out-of-network providers.** Plans are required to cover the items and services described above at out-of-network providers. If the plan has a negotiated rate with such provider in effect before the public health emergency was declared, then the negotiated rate will apply for the duration of the declared emergency. If the plan does not have a negotiated rate with the out-of-network provider, the plan must reimburse the provider equal to the cash price for the service as listed by the provider on a public Internet website (or the plan can negotiate a lower rate than the cash price).
- **SBC material modification notice relief.** Generally, if a plan sponsor makes a material modification to the plan terms or coverage that is not included in the most recent Summary of Benefits and Coverage (SBC) (and that occurs outside of a renewal or reissuance of coverage), the plan must notify enrollees within 60 days prior to the date on which the modification takes effect. The FAQs clarify that the departments will not take any enforcement action against a plan that makes a modification to provide *greater coverage* related to the diagnosis and/or treatment of COVID-19 but fails to satisfy the SBC advance notice requirement; however, the departments note that plans must provide notice as soon as practicable. When such changes extend beyond the emergency period, all other applicable requirements must be met to update plan documents or terms of coverage. The same relief applies to plans that add benefits, or reduce or eliminate cost sharing, for telehealth and other remote care services.

Excepted benefits

The FAQs clarify that an employer may offer benefits for diagnosis and testing for COVID-19 at an onsite clinic or through an employee assistance program (EAP) that meets the requirements to be considered an excepted benefit while a public health or national emergency declaration is under effect.

Telehealth and other remote care services

The FAQs confirm that an individual who has other health plan coverage in addition to a health savings account (HSA)-qualifying high-deductible health plan (HDHP) could receive coverage for telehealth and other remote care services outside of the HDHP, and before satisfying the HDHP deductible, and still be eligible to contribute to his or her HSA.

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California court addresses unlimited PTO policies

By Rich Gisonny and Ben Lupin

On April 1, 2020, a California Court of Appeals issued a ruling in a case that is reportedly the first to address whether, under a purportedly unlimited time off policy, an employer must pay for unused vacation time or paid time off (hereinafter collectively referred to as PTO) at termination of employment. In *McPherson v. EF Intercultural Foundation, Inc.*, the court held that such a determination must be made on a case-by-case basis and issued guiding principles to consider (among other facts and circumstances) when determining whether a PTO policy is actually "unlimited" or whether it requires accrual or payout at termination.

Background

Although PTO policies are not mandatory in California, employers that choose to implement such policies must comply with California Labor Code requirements that the employer pay as wages any vested (accrued but unused) PTO at termination of employment.

Under "unlimited" or "flex" PTO policies, employees are generally allowed to take an unspecified amount of PTO without actually accruing any days off and to take PTO whenever and for whatever amount of time they would like, subject to completing assigned work. Employers have generally taken the position that an unlimited PTO policy requires neither accrual nor payout at termination.

The court's decision

In *McPherson*, the employer's policy – *which was not in writing* – provided that certain employees could take PTO but would not accrue paid days off. These employees were not required to request to take time off or to track it; instead, they were required to notify their supervisors before taking time off – but "highly discouraged" from doing so during busy season.

The evidence in the case showed:

- Employees "had the right to take an amount of approved vacation that was within the amounts typical of most jobs at the employer (i.e., at least 20 days' paid vacation per year) even if there was no precise amount expressly stated or agreed upon."

[A]s long as unlimited PTO policies are properly designed, administered and communicated, they are permissible under California law.

- The employer did not make clear that such PTO was not part of the employees' compensation, even though the employer may have referred to its vacation policy as "unlimited" or "uncapped."
- The employer did not expressly convey or document the "unlimited" nature of its PTO policy.

Based on these facts, the court determined that the employer's policy was *not* an unlimited vacation policy because, while the amount of PTO time was not defined, the time actually available for approval was impliedly limited. The Court of Appeals affirmed the trial court's conclusion that the employees were due as wages the amount of PTO implied to be provided in the policy (i.e., 20 days per year), less the PTO actually taken, at termination of employment.

However, the court also recognized that, as long as unlimited PTO policies are properly designed, administered and communicated, they are permissible under California law.

Guiding principles for unlimited PTO policies

The following are the guiding principles set forth by the court for establishing unlimited time off policies (they assume the policy is *in writing*):

- The written policy should clearly provide that employees' ability to take PTO is not a form of additional wages for services performed but part of the employer's promise to provide a flexible work schedule – including employees' ability to decide when and how much time to take off.
- The written policy should spell out the rights and obligations of both employee and employer and the consequences of failing to schedule PTO.

- The written policy, *in practice*, should allow sufficient opportunity for employees to take PTO or work fewer hours in lieu of taking PTO.
- The written policy must be administered fairly so that it neither becomes a de facto "use it or lose it policy" nor results in inequities.

Going forward

California employers that have "unlimited" PTO policies should review those policies with legal counsel, keeping in mind the court's guiding principles. Note that some of the guiding principles focus on the policy document, while others address how to apply the policy in practice. To mitigate risk, employers should conduct ongoing administrative oversight to ensure their written policies work in practice.

All employers (whether in California or not) that maintain "unlimited" PTO policies or are considering implementing such policies should ensure they are in compliance with applicable state laws (including wage payment laws at termination).

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PBGC fine-tunes regulations to improve effectiveness and clarity

By Stephen Douglas, Bill Kalten, Mike Pollack and Maria Sarli

The Pension Benefit Guaranty Corporation (PBGC) has issued **final regulations** that make miscellaneous technical corrections, clarifications and improvements to its Reportable Events and Certain Other Notification Requirements, Annual Financial and Actuarial Information Reporting, Termination of Single-Employer Plans and Premium Rates. The changes were the result of a "retrospective regulatory review" intended to improve the effectiveness and clarity of PBGC regulations. The most significant changes are discussed below.

Reportable events

Active participant reduction

Under the prior regulation, an active participant reduction reportable event generally occurred when, as a result of a single-cause event or through normal attrition, the number of active participants[1] in a plan was reduced below 80% of the number at the beginning of the year (one-year lookback) or below 75% of the number at the beginning of the prior year (two-year lookback).

Elimination of "75% of prior year" trigger. The final regulation eliminates the "less than 75% of the active participant count at the beginning of the prior year" trigger for reporting for the active participant reduction reportable event.

Elimination of duplicative reporting. An active participant reduction reportable event caused by a "single-cause event" must be reported within 30 days after the reduction occurs; one caused by attrition must be reported by the premium filing deadline for the plan year following the plan year during which the attrition event occurred. Because this could have led to unintended duplicative reporting, PBGC issued guidance in 2017 to "fix" the issue, which it now incorporated into the regulations. Specifically, participants terminated due to a single-cause event that was reported to the PBGC are added back to the participant count at the end of the year for purposes of determining whether an attrition event has occurred (i.e., for purposes of determining whether the end-of-year active participant count is less than 80% of the beginning-of-the-year count).

The changes were the result of a "retrospective regulatory review" intended to improve the effectiveness and clarity of PBGC regulations.

Multiple single-cause events. The final regulations clarify that separate single-cause active participant reduction events that occur during the same plan year must each be reported separately within 30 days after the event. Thus, each time a new single-cause event results in an active participant reduction greater than 20% of the number of active participants at the beginning of the plan year, a new Form 10 must be filed.

[1] The final regulation clarifies that an active participant is an individual who is receiving compensation from any member of the plan's controlled group for work performed for any member of the plan's controlled group.

Elimination of overlapping reporting. The final rules clarify that an active participant reduction would not need to be reported if the reduction was attributable to a substantial cessation of operations or a withdrawal from a multiple employer plan and had already been timely reported under section 4062(e) or section 4063(a) of the Employee Retirement Income Security Act (ERISA) *before* the reportable event filing would otherwise be due.

Failure to pay benefits when due. A failure to pay benefits when due caused by the need to determine whether a participant is eligible for the benefits is not subject to the time limit (two months) that applies to other administrative delays (for purposes of determining whether the "inability to pay benefits when due" reportable event has occurred). Note that the separate exclusion remains for a failure to pay a participant who cannot be located.

Change in contributing sponsor or controlled group. The criteria for the "change in contributing sponsor or controlled group" reportable event with respect to post-event reporting have been clarified. Previously, the reference to "a change in contributing sponsor" appeared only in the title of section 4043.29 and not in the text itself, leading to confusion. PBGC clarified that a change in contributing sponsor without a change in the controlled group is not subject to post-event reporting and removed that reference from the heading of the regulation.

Liquidation and insolvency. When companies cease operations and then sell off their assets (i.e., liquidate) over time, the PBGC considers the cessation to be part of the liquidation process. To avoid confusion as to when a reportable event is triggered in this scenario, the PBGC clarified the definition of the liquidation event for a controlled group member. Any cessation of revenue-generating operations is now a reportable liquidation event; the trigger for reporting a liquidation event occurs when a decision is made to liquidate, not when liquidation activities begin.

Also, in order to avoid the need to report a liquidation decision that has not yet been made public, the deadline for reporting a liquidation was extended if any contributing sponsor – or the parent company within a parent-subsidiary controlled group of such contributing sponsor – is a public company. The extended deadline is the earlier of (a) the date a press release on the liquidation is issued, or (b) the timely filing of a Securities and Exchange Commission (SEC) Form 8-K disclosing the event.

[T]he trigger for reporting a liquidation event occurs when a decision is made to liquidate, not when liquidation activities begin.

Public company waivers. Certain reportable event filings are waived for public companies if the contributing sponsor timely files an SEC Form 8-K disclosing the event. The final rule extends this waiver to situations where the parent company of a contributing sponsor, who is not a contributing sponsor, reports the event on Form 8-K. The regulations provide the information that must be included in the Form 8-K to qualify for this waiver.

Company low default risk safe harbor. The regulations provide for a "low default risk safe harbor" for waivers of certain reporting requirements. The final rule clarifies that the "commercial measures criteria," which is one of the possible criteria used to meet the safe harbor, must be satisfied on the basis of information provided by a third party, not by the company itself. The commercial measures criteria are that the probability that the company will default on its financial obligations is neither more than 4% over the next five years nor more than 0.4% over the next year.

ERISA section 4010 filings

ERISA section 4010 requires the reporting of actuarial and financial information by controlled groups with single-employer pension plans that are funded below certain thresholds.

The final regulations make certain changes dealing with identifying legal relationships of controlled group members, consolidated financial statements, calculating the funding target for purposes of the section 4010 funding shortfall waiver and valuing cash balance plans for purposes of the liability information that must be reported to PBGC.

The most significant changes or clarifications in the final regulations are discussed below.

ERISA section 4010 calculations for benefit liabilities or filing waivers

The final regulations:

- **Provide guidance on valuing benefit liabilities for cash balance plans.** For purposes of calculating benefit liabilities

at the end of the plan year ending within the information year, benefits must be assumed to be paid as annuities. As a result, it is necessary to convert current cash balance accounts to annuities payable at expected retirement age. The final regulations require annuities to be calculated in the same manner they would be calculated if the plan were terminated at the end of the plan year ending in the information year. This means that the interest credit rate and annuity conversion interest rate would generally be the average rates used under the plan for the preceding five years.

- **Provide that the calculation of the funding target for purposes of the "less than $15 million §4010 funding shortfall" waiver does not reflect at-risk assumptions.** The proposed regulation was unclear with respect to this calculation for plans that are at-risk. The final rule provides that the special rules for at-risk plans in ERISA and the tax code "are disregarded for purposes of determining the funding target underlying the §4010 funding shortfall for a plan, even if the plan is in at-risk status."
- **Codify an interpretation of the "less than $15 million §4010 funding shortfall" and "fewer than 500 participants" filing waivers.** The final regulations clarify that only plans that are maintained by a member of the controlled group on the last day of the information year are considered in determining whether these waivers apply.
- **Do not adopt a proposal that would have provided for filing waivers due to "late elections" to reduce funding balances.** The proposed regulations would have recognized "late elections" to reduce funding balance for purposes of the 80% funding target attainment percentage reporting trigger by providing for a reporting waiver when a timely election to reduce funding balance would have eliminated the requirement. However, after considering received comments, the PBGC concluded that since the proposal left many questions unanswered and would likely help few, if any, filers, it would not adopt the proposed waiver.

Information required for ERISA section 4010 filing

The final regulations:

- **Eliminate the requirement to determine and submit individual financial information for each controlled group member.** Under prior regulations, a filer is permitted to submit consolidated financial statements if the financial information of a controlled group member is combined with the information of other members in a consolidated statement; however, if consolidated information is reported, revenues, operating income and net assets for each controlled group member included in the consolidation also must be reported. The final rules eliminate the requirement to provide separate financial information for each controlled group member but not with respect to controlled groups with foreign parents (see below).
- **Limit financial information that needs to be provided by U.S. entities with foreign parents.** Where the ultimate parent is a foreign entity and consolidated financial information for the entire controlled group is provided, the final regulations require financial information for only the U.S. entities in the controlled group (disregarding any exempt entities). This means that in addition to the consolidated statements for the whole controlled group, the filer must submit consolidated financial statements on only the U.S. entities that are members of the controlled group. If consolidated information is not available, the filer must provide separate financial statements, or tax returns if financial statements are not available, for controlled group members that are U.S. entities.

For controlled groups with 10 or fewer members, each member only has to report its relationship to the *plan sponsor.*

- **Streamline the requirements to report relationships among controlled group members.** Rather than separately specifying the legal relationships of each controlled group member to the other members (e.g., parent, subsidiary), as previously required, for controlled groups with more than 10 members an organizational chart or similar diagram must be submitted, showing the members of the controlled group and the legal relationships of the members *to each other.* For controlled groups with 10 or fewer members, each member only has to report its relationship *to the plan sponsor.*
- **Clarify that when publicly available financial information is provided, the PBGC must be given clear directions to the exact web page (URL) where the information can be found.** In addition to providing the exact URL, the filer must advise PBGC as to when the information was made available to the general public.

Form 501 Post Distribution Certification for Standard Plan Terminations

- **Permit the Form 501 post distribution certification to be provided up to 60 days, rather than 30 days, after assets are distributed, as long as the PBGC is notified (e.g., via email) of the final distribution within 30 days.** This change addresses the challenge of collecting all the information required to be submitted (e.g., documentation that benefit obligations were settled for all participants,

including copies of cancelled checks in the case of lump sum distributions) within 30 days of the final distribution of assets to all participants.

Changes to the premium rate rules

The most important changes to the regulations on determining premium rates are as follows:

- For spinoff terminations, the exemption from the variable rate premium in the year of termination does not apply when more than a de minimis portion (i.e., more than 3%) of the plan's assets are spun off during the plan year of termination before terminating the remainder of the plan. In addition, the proration of the flat rate (i.e., per participant) premium in the year all assets are distributed due to a plan termination only applies when there has been no spinoff during that plan year, unless the spinoff was de minimis. Thus the final rules eliminate these special provisions in cases where plan termination does not involve the vast majority of plan participants. Note that the latter provision (inapplicability of proration of flat rate premium) applies only prospectively (for 2020 and later plan years), while the former provision (inapplicability of availability of the variable rate premium exemption) is a "clarification" of the prior rules.

[A] merger is only treated as de minimis…if the smaller plan merges into the larger plan.

- For mergers at the beginning of the plan years of both plans, a merger is only treated as de minimis (meaning that the participant count date remains the last day of the prior plan year) if the smaller plan (i.e., the plan with less than 3% of the assets of the larger plan) merges into the larger plan. This prevents the exclusion of large groups of participants from the flat rate premium calculation when larger plans merge into much smaller plans.

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House proposes annual disclosure of human capital metrics

By Ann Marie Breheny and Steve Seelig

In February 2020, the House Financial Services Committee approved the Workforce Investment Disclosure Act, which would require company annual 10-K filings to include a disclosure of workforce demographics, workforce stability, training and capabilities, health and safety, culture and empowerment, and compensation and incentives. The bill is cleared for action on the House floor. The House could vote on the proposal, but Senate action is not expected.

Background

In March 2019, the Securities and Exchange Commission (SEC) Investor Advisory Committee issued a **recommendation** that companies should disclose human capital metrics that would provide similar insights to shareholders as would be required by the proposed bill.

Then in fall 2019, the SEC included a human capital component in its proposal to modernize Regulation S-K, which provides requirements for public company disclosures. The component encourages companies to take a flexible, principle-based approach to disclose certain measures that management focuses on and that it deems material to understanding a registrant's business. This latter provision is expected to be finalized this spring.

Proposed disclosures

The Workforce Investment Disclosure Act would require more qualitative disclosures that align measurements with business goals (see items 4 and 5 on the next page) and would permit the SEC to expand those disclosures:

1. **Workforce demographics** – including information on the number of full-time, part-time and contingent workers as well as policies and practices relating to subcontracting, insourcing and outsourcing
2. **Workforce stability** – including information about voluntary and involuntary turnover rates, internal hiring and internal promotion rates

3. **Workforce composition** – including data on the gender, racial and ethnic composition of the workforce; information about diversity policies; and audits (workforce stability information from item 2 on the previous page would also be broken out by gender, racial and ethnic components)
4. **Workforce skills and capabilities** – including information about training (e.g., the average number of hours of training and spending on training per employee per year), skills gap, and the alignment of employee skills and capabilities with business strategy
5. **Workforce culture and empowerment** – including:
   - Policies and practices regarding freedom of association and work/life balance
   - Incidents of verified workplace harassment (during the five prior fiscal years)
   - Policies and practices relating to employee engagement and wellbeing, including:
     - Management discussions about creating an autonomous work environment
     - Fostering a sense of purpose in the workforce
     - Trust in management
     - A supportive, fair and constructive workplace
6. **Workforce health and safety** – including information about frequency, severity and lost time due to injuries, illnesses or fatalities, plus disclosure of fines and actions under the Occupational Safety and Health Act
7. **Workforce compensation and incentives** – including information about:
   - Total workforce compensation, broken out by full-time, part-time and contingent workers
   - Policies and practices about how performance, productivity and sustainability are considered when setting pay and making promotion decisions
   - Policies and practices regarding incentives and bonuses provided to those who are not named executives (including policies and practices to counter any risk created by such incentives)
8. **Workforce recruiting and needs** – including the number of new jobs created, the worker classification of new jobs, information about the quality of hire and new hire retention rate

If the proposal is enacted, the SEC would have 270 days to study whether additional disclosures would be of value to shareholders and one year to report the results to Congress, including information about human rights commitments of issuers, principles used to evaluate risk, constituent consultations and supplier due diligence; violations of the Fair Labor Standards Act; more detailed employee demographic information; and the results of employee satisfaction surveys.

The SEC would have two years to issue final regulations for implementing the disclosure requirements; however, issuers would need to comply as of the date of enactment. Issuers would be in compliance with the law prior to the SEC issuing final regulations if annual report disclosures satisfy the public disclosure standards of the International Organization for Standardization's ISO 2 30414, or any successor standards for external human capital reporting, as supplemented or adjusted by the commission.

The bill...indicates a continued focus on requiring companies to describe the elements and value of human capital in their 10-Ks.

The bill is not expected to become law but indicates a continued focus on requiring companies to describe the elements and value of human capital in their 10-Ks.

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WTW Pension 100: Year-end 2019 disclosures of funding, discount rates, asset allocations and contributions

By Brendan McFarland

Despite the strongest investment performance witnessed by plan sponsors over the past decade, the aggregate funded status[1] of defined benefit plans in the Willis Towers Watson (WTW) Pension 100[2,3] managed to rise only slightly, from 86.0% in 2018 to 86.9%. While sizeable returns helped boost plan assets, lower interest rates increased plan liabilities, mitigating the majority of the investment gains witnessed over the year.

This annual analysis is based on just-reported pension disclosures from the Securities and Exchange Commission (SEC) 10-K filings of 100 publicly traded U.S. sponsors of large pension plans whose fiscal years end in December.[4] We examine reported funding results, the discount rates used to measure liabilities, target asset allocation policies over time, investment returns and plan contributions. Where applicable, historical values are shown for companies in the current WTW Pension 100.

Among these WTW Pension 100 plans, the gap between liabilities and assets has widened substantially. Between 2007 and 2012, funding dropped from an $81 billion-dollar surplus to a $293 billion-dollar deficit – the largest deficit in our analysis (Figure 1).

The following year, higher interest rates reduced plan liabilities – reversing a four-year trend – and assets grew, cutting the prior year's deficit in half. By year-end 2014, however, interest rates started their decline and, combined with the adoption of longer life expectancy assumptions among most sponsors, pushed deficits back up to $244 billion. In 2015, when rising interest rates drove liabilities down, returns were poor, while in 2016, returns were good, but interest rates dropped back down. Both years ended with minimal movement in funded status.

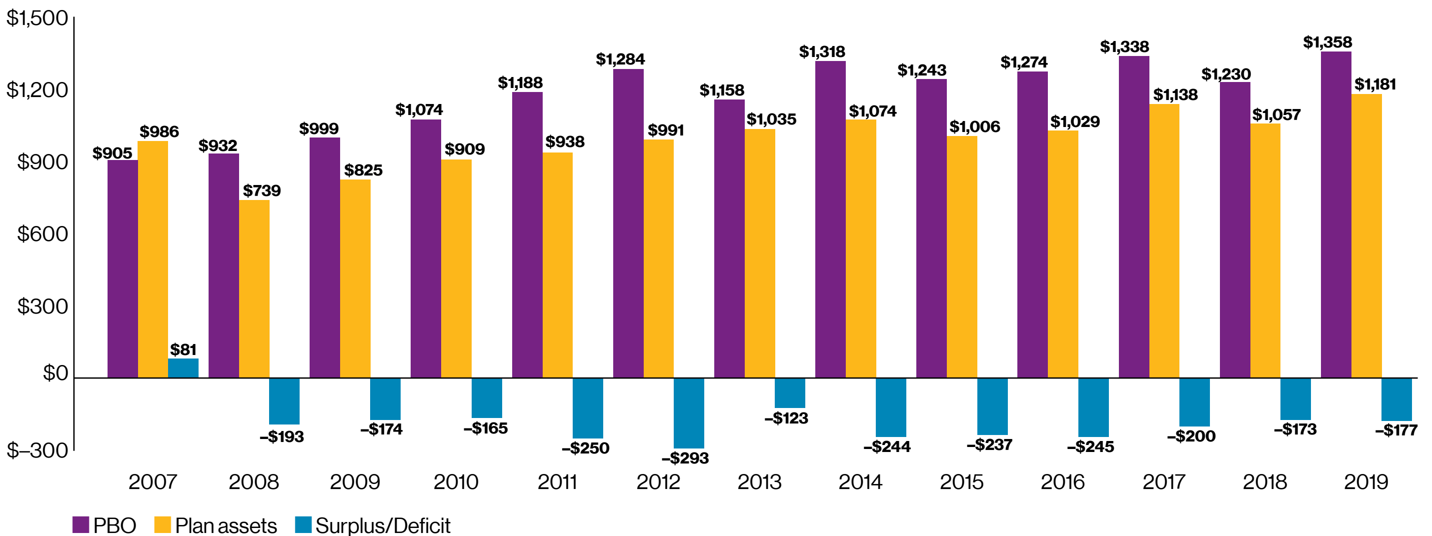
[1] The aggregate funded status is the ratio of (a) the sum of all assets to (b) the sum of all projected benefit obligations (PBO) for the 100 companies. Average funded status is calculated by averaging the ratio of (a) to (b) on an individual company basis.

[2] The 2019 WTW Pension 100 consists of sponsors of the largest U.S. pension programs among U.S. publicly traded organizations, ranked by PBO at year-end 2018. For some companies, the allocation between U.S. and non-U.S. plans is estimated.

[3] Pension liability values in 10-Ks also reflect nonqualified plans (which are usually not shown separately). An analysis of companies that disclose their qualified and nonqualified plans separately found that funded status is typically eight percentage points higher without the nonqualified plan obligations because these plans are typically not funded.

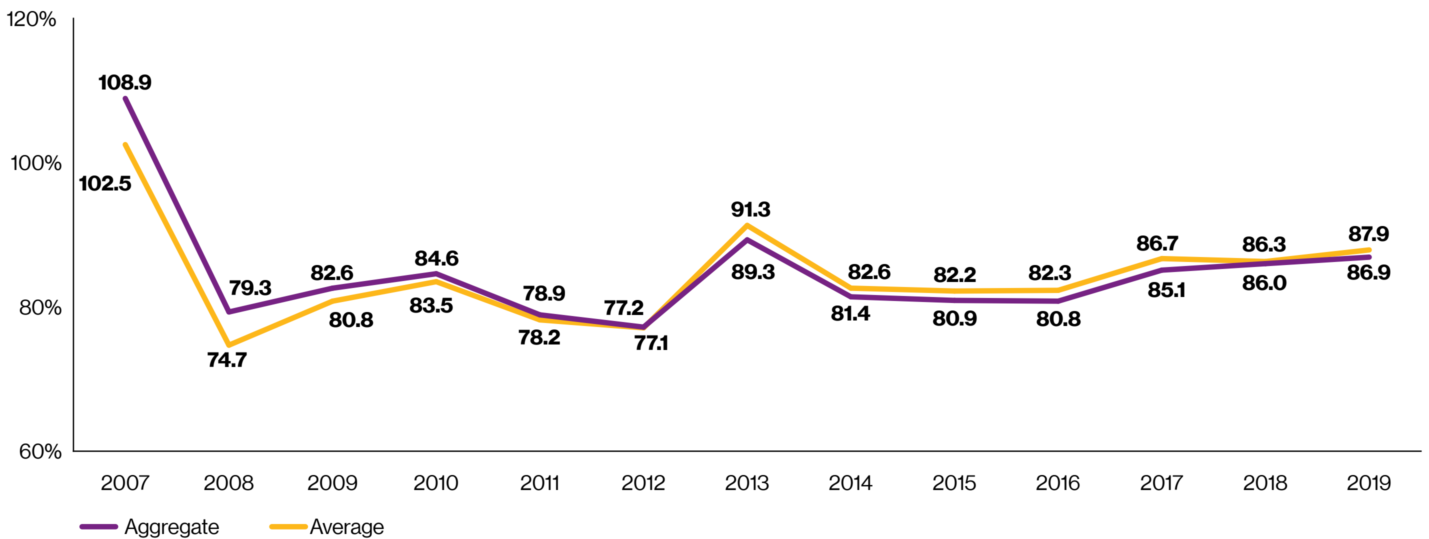
[4] See "**WTW Pension 100: Year-end 2018 disclosures of funding, discount rates, asset allocations and contributions**," *Insider*, May 2019.

Figure 1. **Aggregate funding levels for WTW Pension 100 ($ billions), 2007 – 2019**



Source: Willis Towers Watson

Figure 2. **Aggregate and average funded status for WTW Pension 100, 2007 – 2019**



Source: Willis Towers Watson

Over 2019, once again both plan assets and obligations moved in tandem.

By year-end 2017, interest rates dropped once again, but investment returns were well above expectations, and employers made substantial contributions to their plans – the largest witnessed during the period of analysis. Assets grew by more than obligations, materially reducing the deficit for the first time in four years. During 2018, both plan obligations and assets declined. Although interest rates ticked up, investment returns were the worst realized since the financial crisis of 2008; however, thanks to another year of large aggregate pension contributions, liabilities fell by slightly more than assets, pushing funding levels up slightly.

Over 2019, once again both plan assets and obligations moved in tandem. This time around, sponsors witnessed historically low interest rate levels, which were offset by the strongest investments gains witnessed during this period of analysis, pushing up funding ratios ever so slightly for the third year in a row (albeit with very little change in the aggregate deficit).

Funded status increases for the third year in a row

Among WTW Pension 100 companies, in 2019 plan obligations increased by 11%, while plan assets increased by roughly 12%. While funded levels improved, the overall deficit increased by $4 billion – from $173 billion to $177 billion – a 2% increase over the year. The overall deficit has declined by $116 billion between its peak in 2012 and 2019, as investment returns and employer contributions outpaced the growth in liabilities associated with declining interest rates. Among these same companies, aggregate funded status climbed to 86.9% by the end of 2019, up from 86.0% in 2018, 85.1% in 2017 and 80.8% in 2016 (Figure 2). Over the past year, average funded status also witnessed an increase, moving from 86.3% at the end of 2018 to 87.9% at the end of 2019.

Figure 3 shows the distribution of funded status since 2007, reflecting some significant shifts over the analysis period and a minor shift from 2018 to 2019. The number of companies

Figure 3. **Distribution of funded status for WTW Pension 100, 2007 – 2019**

	2007	2008	2009	2010	2011	2012	2013	2014	2015	2016	2017	2018	2019
100% or more	50%	4%	7%	8%	6%	5%	21%	6%	6%	7%	13%	11%	13%
90% to 99%	25%	11%	10%	17%	8%	10%	25%	17%	13%	14%	27%	25%	29%
80% to 89%	17%	19%	33%	36%	26%	23%	35%	34%	37%	34%	29%	34%	30%
70% to 79%	6%	26%	31%	28%	32%	34%	15%	33%	32%	29%	21%	22%	23%
Under 70%	2%	40%	19%	11%	28%	28%	4%	10%	12%	16%	10%	8%	5%

Source: Willis Towers Watson

whose funded status was 90% and greater increased from 36% in 2018 to 42% in 2019. On the other end of the spectrum, funding levels were below 70% for five companies, compared with eight companies in 2018. While levels have improved for most over the year, companies are still nowhere near 2007 levels, when 75% of companies in this analysis had funding levels that were 90% or greater.

Figure 4 shows the changes in funded status from 2018 to 2019. As noted earlier, average funded status improved over 2019. On a company basis, funded status improved for 68 sponsors and declined for 32. The funding increases were between 0.1 and 4.9 percentage points for 53 companies and were five percentage points or more for another 15 companies (owing to large plan contributions explained later in this study).

Discount rates dropped to historical levels in 2019

Plan obligations increased by roughly 11% in 2019, mostly due to a decline in discount rates used to measure pension obligations. From 2008 through 2012, discount rates fell every year – an accumulated decline of 234 basis points – before finally rising in 2013 (Figure 5). Interest rates fluctuated over the next couple of years but then fell in both 2016 and 2017. In 2018, rates ticked back up again. By the end of 2019, rates again plummeted as sponsors witnessed the largest one-year drop over the period of this analysis. Over the year, rates dropped on average by 98 basis points, leaving sponsors at a historically low average rate of 3.29%.

Figure 4. **Changes in funded status for WTW Pension 100, 2018 – 2019**

Change in funded status over the year	Number of companies	Average change in funded status
5.0% or more	**15**	**6.9%**
0.0% to 4.9%	**53**	**2.2%**
–0.1% or less	**32**	**–2.1%**
Total	**100**	**1.6%**

Source: Willis Towers Watson

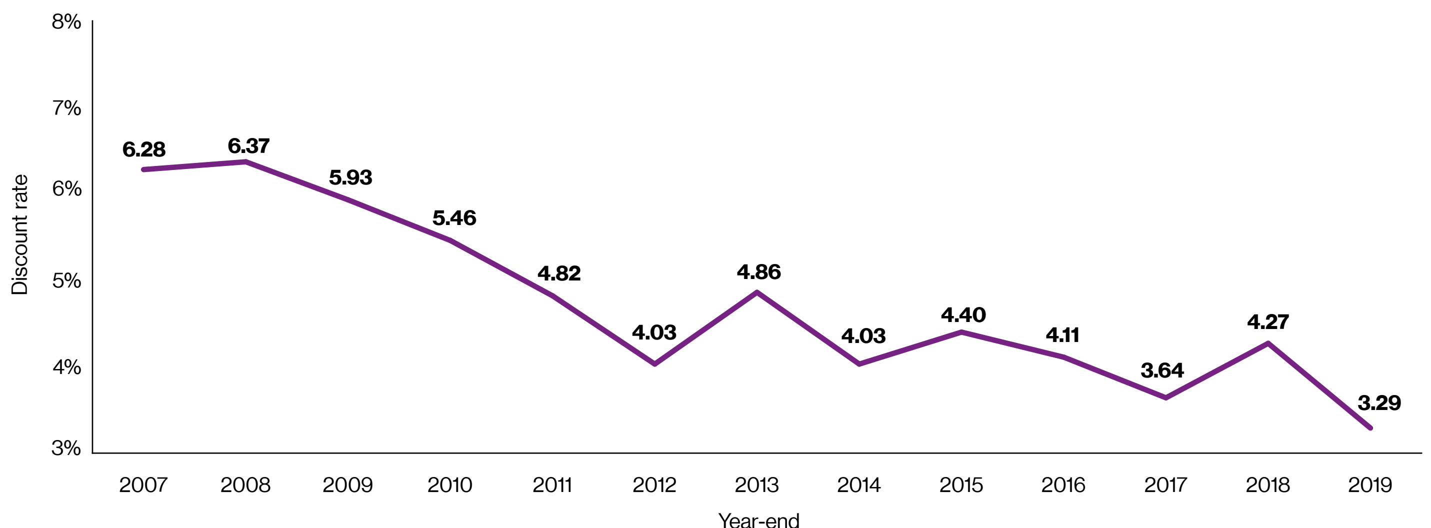
Over the year, rates dropped on average by 98 basis points, leaving sponsors at a historically low average rate of 3.29%.

Shift to more conservative investments continues at slower pace

Over the past decade, a gradual shift from public equities to fixed-income and alternative assets reflects growing interest in hedging funded status and reducing market risk exposure (Figure 6, next page). Since 2009, the average target allocation to public equities declined by close to 18 percentage points, while target allocations to fixed-income investments rose by around 15 percentage points.

The substantial shifts to fixed-income holdings between 2008 and 2013 (reflected in the 2014 target allocation column)

Figure 5. **Average year-end discount rate assumptions for WTW Pension 100, 2007 – 2019**



Source: Willis Towers Watson

Figure 6. **Average *target asset* allocation percentages for WTW Pension 100, 2009 – 2020***

	2009	2010	2011	2012	2013	2014	2015	2016	2017	2018	2019	2020	2020 (aggregate)
Public equity	54.9%	52.6%	50.8%	47.2%	45.7%	43.4%	42.8%	42.5%	42.1%	40.6%	38.0%	37.3%	33.6%
Debt	33.9%	34.3%	35.5%	38.5%	39.8%	42.0%	42.6%	43.0%	43.3%	45.3%	47.9%	48.5%	48.8%
Cash	0.4%	0.9%	1.1%	0.9%	0.9%	1.0%	1.0%	1.0%	1.1%	1.1%	1.2%	1.4%	1.4%
Real estate	3.2%	3.3%	3.0%	3.0%	3.0%	3.0%	3.2%	3.3%	3.3%	3.1%	3.0%	3.4%	4.7%
Other	7.6%	8.9%	9.7%	10.4%	10.6%	10.6%	10.4%	10.2%	10.3%	9.9%	9.9%	9.4%	11.5%

Source: Willis Towers Watson
*Represents investment strategies for each oncoming year

slowed during the next few years but then picked back up again over 2017 and 2018 (reflected in the 2018 and 2019 columns). On average, fixed income holdings ticked up by 2% going into 2018 and 3% at the beginning of 2019. Over 2019, movement slowed relative to previous years as fixed-income increased by roughly 1%.

Out of the 92 companies that reported target asset allocation information for both 2019 and 2020, 10 reduced their target equity allocation by five percentage points or more, with an average reduction of roughly 12 percentage points; on average these 10 companies had higher funding levels than our overall sample (94.3% versus 87.9%).

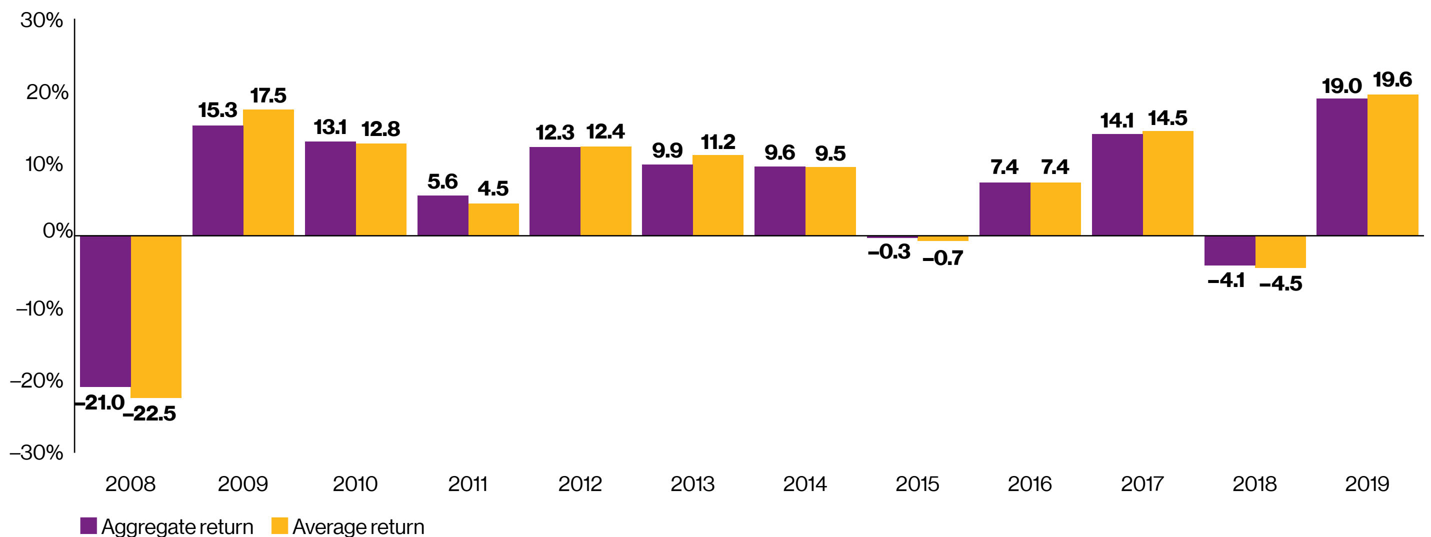
These recent allocations to fixed income could reflect higher funding levels triggering or accelerating de-risking strategies, such as glide paths, which reduce equity exposure as the plan moves closer to full funding. Only four companies increased their equity exposure by five percentage points or more over the year, with an average increase of 10 percentage points.

Similar to past studies, aggregate results (weighted by plan assets) differ from average results going into 2020, which suggests that allocations vary by size. On an aggregate level, sponsors of the largest plans hold less in public equities and more in real estate/other alternative investments, indicating the larger plans in this analysis have more alternative investments than the smallest.

Sponsors realize strongest investment returns over the period of analysis

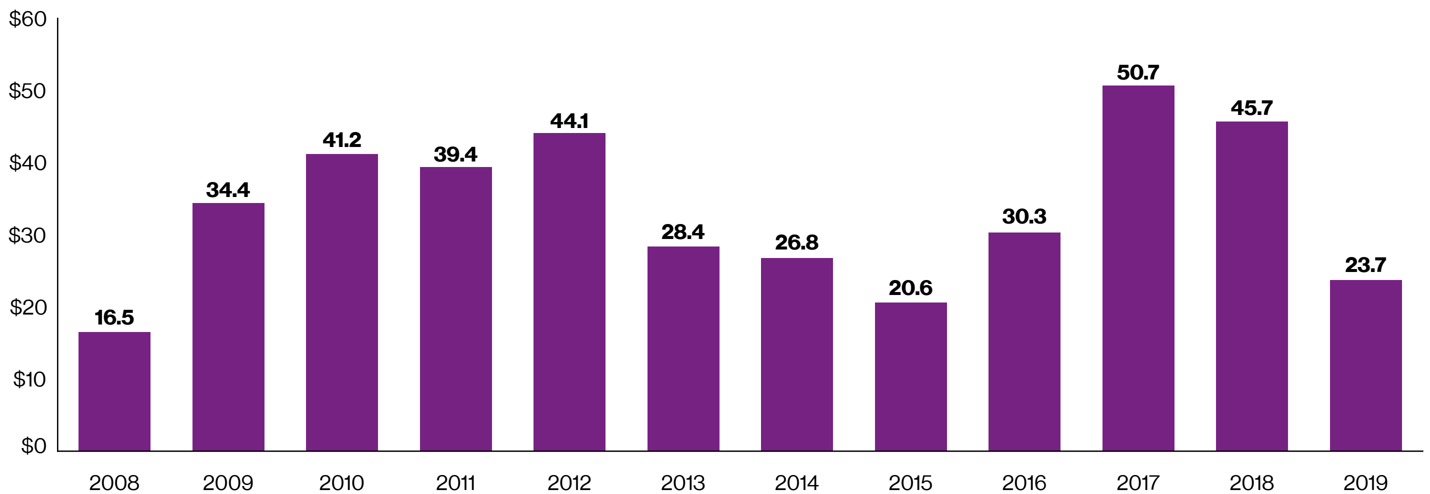
Over 2019, both stock and bond markets were fortuitous for plan sponsors. Domestic large capitalization equities grew 32%, while domestic small/mid-capitalization equities realized gains of 28%. At the same time, aggregate bonds recognized gains of 9%, while long corporate and long government bonds, typically used in liability-driven investing strategies, realized gains of 23% and 15%, respectively. These strong market performances left sponsors witnessing the strongest returns realized over the period of our analysis (Figure 7).

Figure 7. **Investment returns for WTW Pension 100, 2008 – 2019**



Source: Willis Towers Watson

Figure 8. **Plan contributions from WTW Pension 100 ($ billions), 2008 – 2019**



Source: Willis Towers Watson

In 2019, WTW pension investment returns averaged 19.6% (aggregate returns were 19.0%), well above expectations.

In 2019, WTW pension investment returns averaged 19.6% (aggregate returns were 19.0%), well above expectations of almost 7%, which helped drive up plan assets and funding levels over the year.

Averaged over the past three years, annualized returns for the WTW pension 100 were 9.3%, above expectations. Since 2008, annualized investment returns have averaged 6.4% – which are at or just under expectations – largely attributed to significant losses in the 2008 financial crisis. Returns averaged roughly 9% over the post-financial crisis 11-year period between 2009 and 2019. On average, these plan sponsors' returns outperformed expectations in eight of the past 12 years.

Contributions for sponsors dropped after two strong years

WTW Pension 100 companies contributed $23.7 billion in 2019 – down 48% from 2018 and the third-lowest period of contributions since 2008 (Figure 8). Aggregate contributions in 2017 and 2018 were the highest realized in this analysis, during a time when sponsors were responding to rising Pension Benefit Guaranty Corporation premiums, the attractiveness of borrowing to fund pensions, growing interest in de-risking strategies and a desire to prefund future contributions. Most important, the Tax Cuts and Jobs Act of 2017 reduced federal corporate tax rates starting in 2018 and, as a result, increased the relative value of the pension tax deduction for earlier tax years. Plan contributions normalized in 2019 as sponsors benefitted from the flexibility provided by prefunding contributions.

Aggregate contributions were 1.5 times aggregate service cost,[5] which was $15.7 billion in 2019.

[5] Service cost refers to the present value of the projected retirement benefits earned by plan participants in the current period.

Figure 9. **Plan contributions ($ billions) from WTW Pension 100, 2018 versus 2019**

	Number of companies	Aggregate contributions in 2018	Aggregate contributions in 2019
Larger contributions in 2019	**41**	**$7.1**	**$16.5**
Same level of contributions in 2018 and 2019	**8**	**$0.1**	**$0.1**
Smaller contributions in 2019	**51**	**$38.5**	**$7.1**

Source: Willis Towers Watson

While aggregate contributions were down substantially in 2019, roughly half made smaller contributions than what was contributed in 2018 (Figure 9), as there were several large sponsors that made sizeable contributions in 2018.

Most companies whose funded status increased substantially during 2019 made relatively large plan contributions. Among companies whose funding levels rose by more than five percentage points, the average ratio of plan contributions to plan assets was 7%, compared with 3% for the entire WTW Pension 100 and 2% for the 32 companies whose pension funding declined in 2019.

Conclusion

Over 2019, while sponsors watched interest rates used to measure their pension obligations drop to historical levels – driving up plan liabilities – they were fortunate to ride the wave of strong financial markets, leaving their pension plans in slightly better funding positions than what was realized at the end of 2018.

Over the first three months of 2020, the tables turned on sponsors as equity markets crashed due to fears of the coronavirus. While interest rates were highly volatile throughout the first quarter, corporate bond yields ended up mostly flat. The combined effect drove funding levels down significantly, to a level not seen since 2012.[6] Given the marketplace uncertainty, plan sponsors will want to assess the effects on their retirement program costs as well as their outlook for future cash funding requirements, as the current period of funding relief is scheduled to sunset. We anticipate that sponsors will revisit their funding, investment and de-risking strategies as they seek to address rising costs and manage risk prospectively.

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[6] See Willis Towers Watson press release "**COVID-19 takes bite out of U.S. corporate pension plans**," April 2, 2020.

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