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Meeting of the American Academy of Actuaries Multiemployer Plans Subcommittee and the Department of the Treasury, PBGC and DOL
February 22, 2017

MPRA Discussion Notes

On February 22, 2017, the Multiemployer Subcommittee of the American Academy of Actuaries[1] (Subcommittee) met with members of the U.S. Department of Treasury (Treasury), the Pension Benefit Guaranty Corporation (PBGC), and the Department of Labor (DOL). The discussion focused on applications by multiemployer pension plans in critical and declining status to suspend benefits or partition liabilities, as permitted under the Multiemployer Pension Reform Act of 2014 (MPRA).

This document summarizes the key points that were discussed at that meeting. The opinions expressed at the meeting are the opinions of the individual meeting participants. For Subcommittee participants these notes do not necessarily represent the official statements or opinions of any board or committees of the American Academy of Actuaries, including the Actuarial Standards Board or the Actuarial Board of Counseling and Discipline or any other actuarial organization, nor do they express the opinions of their employers.

With respect to the government representatives at the meeting, these meeting notes are not official statements of any of the represented agencies and have not been reviewed by its representatives who attended the meetings. The notes merely reflect the Subcommittee's understanding of the current views of the government representatives and do not represent the positions of Treasury, PBGC, DOL, or of any other governmental agency and cannot be relied upon by any person for any purpose. Moreover, the government representatives at the meeting have not in any way approved these notes or reviewed them to determine whether the statements herein are accurate or complete.

<u>Actuarial Assumptions</u>
Much of the discussion pertained to the selection of actuarial assumptions. Treasury stressed the importance of selecting assumptions that are reasonable for the purpose of the measurement, which is a projection of plan solvency. Assumptions that may be reasonable for an actuarial valuation may not necessarily be reasonable for a solvency projection, especially for a plan with highly negative cash flows. Similarly, an assumption that may be considered immaterial for a

[1] The American Academy of Actuaries is a 19,000-member professional association whose mission is to serve the public and the U.S. actuarial profession. For more than 50 years, the Academy has assisted public policymakers on all levels by providing leadership, objective expertise, and actuarial advice on risk and financial security issues. The Academy also sets qualification, practice, and professionalism standards for actuaries in the United States.

valuation may have a material impact on a solvency projection, particularly when the statutory requirement that suspensions must "not materially exceed the level necessary to avoid insolvency" is interpreted narrowly, as required by the regulation. Treasury emphasized that actuarial assumptions used in an application to suspend benefits must be selected with a high degree of rigor, as there is no mechanism to automatically adjust the level of benefit suspensions in future years as experience emerges. For retirees, if future experience is better than expected, there is no obligation to improve benefits; similarly, if future experience is worse than expected, there is no obligation to increase contributions to maintain suspended benefit levels.

The Subcommittee expressed concern that the greater emphasis on assumptions may create a false impression of precision for the solvency projections; actuarial projections over 30 years or more are by nature imprecise. It was acknowledged, by all meeting participants that there is a delicate balance between the desire to minimize benefit reductions while maintaining at least a 50 percent probability of avoiding insolvency. The Subcommittee also expressed concern that recent decisions by Treasury appear to narrow the range for permissible assumptions by applying criteria that are far narrower than have ever generally been applied within the actuarial profession, outside of situations in which statutory authority is given to regulators to set assumptions. Actuarial Standards of Practice (ASOP) Nos. 27 (Section 3.6.2) and 35 (Section 3.4), for example, describe how "different actuaries will apply different professional judgment and may choose different reasonable assumptions. As a result, a range of reasonable assumptions may develop both for an individual actuary and across actuarial practice."

Treasury further explained the impact of a suspension of benefits is much more significant than for a routine annual actuarial valuation, such as meeting minimum funding standards. Therefore, plan actuaries should factor in how assumptions may behave differently for solvency calculations involving cash flow projections when selecting actuarial assumptions for MPRA applications. As part of the application process, plan actuaries should be prepared to provide detailed justification for all assumptions used in the projections.

Discussion continued on how Treasury views certain key actuarial assumptions when it reviews MPRA applications, based on the 12 applications it has received so far. A summary of the views **expressed by Treasury** are as follows:

- *Current mortality rates*. Plan actuaries are strongly encouraged to use recently published tables from the Retirement Plan Experience Committee (RPEC) of the Society of Actuaries (SOA). Any deviations from these tables or adjustments to the mortality rates should be based on a study of plan experience, weighted by benefit amounts. Experience should be sufficient to provide at least partial credibility, if not full credibility. With respect to credibility, Treasury noted that actuaries may wish to consult the regulations it has recently published on the selection of mortality assumptions for valuations of single-employer pension plans.
- *Mortality improvement*. Plan actuaries are also strongly encouraged to use recently published mortality improvement scales from the RPEC. Mortality improvements should be assumed to be generational, rather than finite. Any adjustment or deviation from assuming generational mortality improvements based on the published scale should be supported by information and analysis.

- *Investment return*. The investment return assumption should be appropriate for the purpose of a solvency projection, take into account relevant current economic data, and be free of significant bias.[2] Importantly, Treasury indicated plan actuaries should adequately reflect short-term expectations, especially because in a plan with declining assets the projections are highly sensitive to the returns in the first few years. The possibility that the plan's asset allocation may change over time is another factor to consider. For example, a plan with limited available resources may be forced to reduce allocations to highly volatile or illiquid investments. Finally, strong MPRA applications will include detailed information regarding the consideration of possible future changes in the plan's asset allocation in their justification of the investment return assumption.
- *Other demographic assumptions*. Other demographic assumptions should be appropriate for the purpose of a solvency projection, consider applicable plan provisions, and take into account recent plan experience, including gain/loss analysis by source. Treasury cautioned against using overly simplified assumptions, as an assumption that may be appropriate for an actuarial valuation may not necessarily be reasonable for a solvency projection. Any assumed changes in participant behavior (for example, due to reduced benefit levels or changes in related plan provisions) should be carefully selected, directionally appropriate, and well-justified.

  Treasury also shared the following considerations with respect to certain demographic assumptions. While these are the specific assumptions that were discussed with Treasury and PBGC, they should not be considered an exhaustive list.

  - *Retirement ages*. Plan actuaries are strongly encouraged to assume a distribution of retirement ages to reflect plan experience. This applies separately to active participants and inactive vested participants. For example, if a plan allows participants to retire early with a full actuarial reduction, it may be appropriate for the valuation to assume a single retirement age. Such an assumption would not be appropriate, however, for a solvency projection.
  - *Optional form elections*. Plan actuaries are strongly encouraged to develop an assumption based on plan experience. Even if optional forms of payment under the plan are actuarially equivalent, different forms may have significantly different cash flows. For that reason, while a simplified assumption that all participants elect a single form of payment may be appropriate for a valuation, it may not be appropriate for a solvency projection. Also, an assumption for future optional form elections may be important for reflecting the PBGC guarantee level for a surviving spouse benefit.
  - *New entrant ages*. When performing an open group projection, actuaries are strongly encouraged to develop a distribution of ages for new active participants based on plan experience. Use of a single age for this purpose is overly simplified and not appropriate. Experience should avoid survivor bias; in other words, it may

[2] These expectations from Treasury with respect to the investment return assumption are described in detail in the notification letter to the Central States, Southeast, and Southwest Area Pension Fund dated May 6, 2016. This letter can be found at www.treasury.gov/mpra.

not be reasonable to simply use the current participant population with short service to represent the expected new entrant population.

- *Exclusion of certain participants*. A common valuation assumption is to exclude certain participants who are considered unlikely to claim their benefits. For example, inactive vested participants who are past either their normal retirement age or required minimum distribution age are sometimes excluded from the valuation, especially in situations where the plan has exhausted all reasonable efforts to locate them. If these participants are later found and put into payment status, they will be included in the annual valuation and will cause an experience loss. Because a proposed suspension of benefits is measured only once, however, plan actuaries are cautioned against excluding older vested participants from the solvency projection.
- *Projected contributions*. Assumptions regarding future contributions—including industry activity, covered work levels, and contribution rates—are developed based on input provided by the plan sponsor, who must act reasonably and in good faith. Plan actuaries should work with the plan sponsor to analyze historical trends in developing appropriate forward-looking assumptions. Plan actuaries should provide justification for the selected assumptions, including narrative descriptions of the input provided by the plan sponsor and the rationale for any deviations from historical trends. In some instances it may be appropriate to anticipate that a recent trend will not continue in the future due to the cyclical nature of the industry. If the projections incorporate this expectation, the application should include a discussion and justification for this approach. With the 10 years of historical data on contribution base units and other variables, Treasury would like an historical narrative describing factors causing changes. This includes addressing any trends or fluctuations that are evident in the recent contribution patterns to the plan.

<u>Plan Sponsor Considerations</u>
As part of the discussion, Treasury expressed the view that the plan sponsor should take into account certain points when designing a proposal to suspend benefits and preparing the application for approval.

- *Effective dates*. Plan sponsors should set the effective date for any proposed suspension of benefits taking into account the amount of time required for Treasury to review the application, to conduct the participant vote, and to follow any procedural rules regarding systemically important plans (those representing at least $1 billion in potential financial assistance from PBGC). To allow adequate time, plan sponsors should set the effective date at least 10 months after the application date. If it is possible that a plan might be considered systemically important under the statute, this period should be increased to 12 months.
- *"Bates stamp" each page*. Treasury requests the plan sponsor to Bates stamp each page in the suspension application. This is an identification process to help easily reference specific pages (the plan's legal counsel should be familiar with the process).
- *Readability of participant notices*. The plan sponsor should carefully consider the content and readability requirements for participant notices. While the model notice provides a safe harbor, the readability requirements apply to the individual benefit estimates and any other customized text. Plan sponsors should avoid or at least limit the use of jargon, and any terms that might not be familiar to participants should be defined.

- *Equitable distribution*. If the proposed suspension of benefits applies different reduction formulas to different participant groups, each benefit formula should be considered a separate group for the purpose of illustrating the effects of the reductions. Additionally, if participants in the plan are currently subject to different benefit formulas, then each current benefit formula also constitutes a separate group. As some plans have complex benefit formulas that have changed over time, it may be difficult to determine how many groupings should be used. Treasury expressed a willingness to meet with plan sponsors before applications are submitted in order to discuss the proper approach to creating and consolidating groupings for the purpose of illustrating the effects of proposed suspensions.

<u>Review Process</u>
Treasury and PBGC also expressed a point of view regarding what plan sponsors should expect after an application to suspend benefits has been submitted and undergoes review. Treasury will have ultimate authority over the review of the application. In addition, PBGC will assist Treasury in its review and Treasury will consult with PBGC and DOL throughout the process.

The plan sponsor should expect the first inquiries associated with the review of the application to come from PBGC. As described below, PBGC will request detailed participant data and calculations from the plan sponsor and plan actuary to determine that the underlying projection calculations are accurate, that the proposed suspensions correctly reflect statutory limitations, and whether or not the plan is systemically important.

While PBGC will request information related to the actuarial projections of solvency, PBGC will not address whether the actuarial assumptions used are acceptable. Later in the process, Treasury will make its inquiries related to the acceptability of the actuarial assumptions, equitable distribution of the proposed suspensions, readability of the participant notices, and other issues related to the statutory and regulatory requirements.

According to Treasury and PBGC, plan sponsors and plan actuaries should be prepared for the following as part of the application review process:

- *Census data*. PBGC will request detailed participant census data from the plan actuary used in the projections of solvency and assess its reliability. PBGC acknowledges that the data used by the plan actuary to perform the solvency projection may not be the same as the data used by the plan sponsor to provide individual estimates and implement the suspensions, if they are ultimately approved. Data should be provided in Excel format. The complete valuation data file should be included.
- *Suspension calculations*. The census data should include calculations of the proposed suspension for each participant. Calculations should show the accrued benefit for each participant before and after the proposed suspension, measured at the effective date of the proposed suspension. The data should reflect the key calculations in applying the statutory limitations, even if those calculations are usually performed within the valuation software. It was also noted that solvency projections should reflect the actual proposed suspension for each participant, not an interpolation, grouping, or approximation that may have been used in modeling.

- *Systemically important calculations*. To determine whether a plan is systemically important, PBGC will request calculations of the *guaranteed benefit* for each participant and beneficiary, reflecting future service and benefit accruals earned up to the projected insolvency date, disregarding any proposed suspension of benefits. This information will be requested unless it is readily apparent from the size of the plan that it is not systemically important. PBGC may also request a projection of employer withdrawal liability payments in the event of plan insolvency.[3]
- *Test lives*. PBGC will request "test lives" showing detailed projections with and without the proposed suspensions. The plan actuary should be prepared to send test lives to PBGC shortly after the application is submitted: at least one active participant, one inactive vested participant, and one retired participant. Year-by-year benefit payment output and rates for each decrement are required. PBGC will evaluate the initial test lives and request additional test lives as needed. PBGC is willing to sign nondisclosure agreements in cases where test life output from the valuation software is considered proprietary. Clear disclosures of any adjustments to the results made outside of the valuation software should be provided. Failure to submit the test lives promptly can impair the ability of the agency to provide a timely assessment of other aspects of the application.
- *Draft plan amendment*. The plan sponsor should draft a plan amendment reflecting the proposed suspension of benefits, so that it is ready to be adopted if the suspension is approved. Treasury may ask to review the draft amendment, even though it is not required as part of the initial application.
- *Prior partial lump sum payments*. In the event that a plan offers partial lump sum payments, the application should include a discussion of how prior payments are reflected in the proposed suspension plan.

Informal Consultation

The discussion touched on the possibility of informal consultation with Treasury or PBGC prior to the submission of an application for a suspension of benefits or a partition. The Subcommittee noted there could be value in plan sponsors receiving informal feedback from Treasury prior to the formal submission of a suspension application. As a follow-up to the meeting, Treasury noted it is open to offering pre-application conferences with plan sponsors to discuss the grouping of participants in the illustrations of the effect of suspensions. Treasury may be willing to discuss certain issues related to the content and form of the application, but not suspension design or equitable distribution.

The Subcommittee also noted there could be value in plan actuaries receiving informal feedback from Treasury on the actuarial assumptions used in performing the applicable solvency projections, and the necessary analysis to support those assumptions. Treasury responded that it would be appropriate to provide feedback on the actuarial assumptions only after conducting a detailed review of the information provided in the suspension application. Plan actuaries should

[3] PBGC is currently establishing the assumptions and methodology it will use in determining whether a plan is systemically important. The actuarial assumptions are expected to be similar to those used to measure mass withdrawal liability.

therefore not expect any specific feedback on actuarial assumptions prior to or shortly after submitting the application.

PBGC continues to encourage plan sponsors interested in a partition or facilitated merger to seek an informal consultation before submitting an application. The informal consultation could address the “impairment” test: whether granting the proposed partition would impair PBGC’s ability to provide financial assistance to other multiemployer pension plans. PBGC noted that how a partition is structured can significantly affect the impairment test. For example, a partition of participants with deferred vested benefits may be less of an impairment on PBGC than a partition of participants already in payment status, even if the actuarial present value of the two possible partitions is the same.

Summary

As mentioned above, the day following the meeting, Treasury confirmed its openness to informal discussions with plan sponsors during the preparation process to discuss benefit groupings. This further demonstrates the desire to help plan sponsors submit successful applications.

The application for benefits suspensions under MPRA represent a significant time and expense for all parties involved. Thus, it is in the best interest of plan sponsors, actuaries, Treasury, and PBGC that there is a high success rate with respect to future MPRA applications. The discussion in this exchange was intended to provide plan sponsors and actuaries with insights about the MPRA application review process with a goal to help plan sponsors make decisions about applying and to increase the acceptance rate for those who do apply.

Meeting participants:

American Academy of Actuaries: (in person) Peter Hardcastle, Monica Konaté, Ted Goldman, Eli Greenblum, Brian O’Konski, Jason Russell, Josh Shapiro (by phone) Jim Dexter, Aldwin Frias, Joe Hicks, Steve Rabinowitz, Pete Sturdivan
Treasury: (in person): Dana Cann, Drew Crouch, Dave Gustafson, Harlan Weller
PBGC: (in person) Chris Bone, Julie Cameron, Jim Donofrio, Deva Kyle, Connie Markakis, Michael Rae (by phone) Darrin French, Cindy Travia
DOL (by phone) Chet Andrzejewski, Graham Boone, Nichole Swift