Notes from Intersector Meeting with PBGC March 12, 2014

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Notes from Intersector Meeting with PBGC
March 12, 2014

These notes were revised May 22, 2014, to include an addendum prepared by Society of Actuaries and Pension Benefit Guaranty Corporation staff.

The Intersector Group is composed of two delegates from each of the following actuarial organizations: American Academy of Actuaries, Society of Actuaries, Conference of Consulting Actuaries, and ASPPA College of Pension Actuaries. Twice a year the Intersector Group meets with representatives of the Pension Benefit Guaranty Corporation (PBGC) to dialogue with them on regulatory and other issues affecting pension practice. Attending from Intersector Group: Tom Finnegan, Eli Greenblum, Heidi Rackley, Maria Sarli, Don Segal, and Larry Sher. David Goldfarb, Academy staff member supporting the Intersector Group, also attended.

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1. Update from PBGC

The Administration's latest budget had a couple of important changes from prior years' budgets with respect to PBGC premiums. The latest budget indicates that PBGC needs to take into account the implications of premium increases for the continuation of plans, and also addresses the need for change in the multiemployer program as well as the single-employer program.

PBGC is setting up a mechanism to review regulations once every five years for actuarial and economic assumptions that affect benefit amounts or liability assessments (such as interest rates, selection of retirement rate category and related expected retirement age tables, and mortality rates). PBGC hasn't looked at current regulations for many years. At this point, PBGC has not reached any conclusions as to what will change. The first issue under review is how PBGC sets interest rates based on the annuity survey. PBGC will then move on to mortality tables and economic factors. PBGC is sensitive to how changes will affect the user community. Minor updates within the existing regulatory structure may be policy or routine regulation updates. Changes that affect benefits will probably go through the usual regulatory process, starting with a proposed regulation. At this time, it isn't clear what process will be used for changes that only affect things like the value of benefits in bankruptcy.

The policy, research and analysis group is paying more and more attention to the multiemployer program after letting it burble along for 30 years. PBGC is adding actuarial support to handle requests for alternative withdrawal liability calculations and partitions, and has also added an economist. PBGC is staffing up the multiemployer side of the negotiations and early warning program (there is no formal early warning program for multiemployer plans, but PBGC still pays attention). PBGC staff is also being more careful when talking about multiemployer benefit guarantees and what happens when a multiemployer plan runs out of money.

2. **Vested benefits reflected in unfunded vested benefit calculation for variable-rate premiums.** Actuarial Standard of Practice No. 4 requires that actuaries spell out what benefits are included whenever they provide a present value of vested benefits (e.g., for variable-rate premium purposes). It would be most helpful if PBGC would spell out — in regulations — **principles** that will help practitioners determine more definitively whether a particular benefit is vested. To date, some answers have been provided only via Blue Book Q&As, and therefore divergence in practice will still result. For example**:**

   a. *"Contingent Benefits"* - 2010 Blue Book Q&A 2 acknowledges that PBGC has not completely defined what a "vested benefit" is, particularly with respect to "contingent benefits" (30 and out benefits are mentioned), and that until they do, practitioners may make a reasonable interpretation of the statute and regulations. Confirmation that benefits that would be vested benefits except that (i) the participant has not yet met the age and service requirements (e.g., early retirement subsidies and Social Security Supplements that are not qualified Social Security supplements), or (ii) the triggering event has not yet occurred (e.g., plant closing benefits) as of the unfunded vested benefit (UVB) valuation date are nonvested would be very helpful.

   b. It appears that any qualified preretirement survivor annuity (QPSA) is treated as vested, and any ancillary death benefit (like a flat $5,000 death benefit) that is only payable on an active participant's death is not. Other pre-retirement death benefits related to the accrued benefit (like a lump sum equal to the present value of the accrued benefit) are less clear. For ancillary retiree death benefits, it appears that a flat amount (e.g., $5,000) is treated as vested if it is available for the rest of the participant's life (so that it is guaranteed to be paid absent a plan amendment), while the answer is less clear for a decreasing death benefit (e.g., grading down to its ultimate level over a period of years).

   c. With respect to amendments adopted after the UVB valuation date it appears that PBGC believes the benefits are vested if they are included in the IRC 430 funding target and the person must only survive to the effective date to receive the benefit, but are not vested if not included in the IRC 430 funding target and/or service after the UVB valuation date is required to be eligible.

   Providing additional guidance on vested benefits is pretty far down PBGC's priority list. It might be possibile to add additional examples to the premium instructions. PBGC would be happy for the Academy Pension Committee or another group to suggest principles and provide examples of how those principles would be applied to various types of benefits.

3. **Uniform due date regulations.** When will the final regulations be published? Will the final regulations include material changes from the proposed regulations? For example, will small plans that don't use year-end valuation dates be allowed to opt out of the "lookback" rule?

The regulations are out. The key changes from the proposed regulations are a one-year transition for small plans (to even out the spacing between payment of 2013, 2014, and 2015 premiums) and an opt-out from the lookback rule for small plans. The final regulations don't provide any details on how the opt-out works — those are in the draft 2014 premium instructions that have been posted on PBGC's website (PBGC does not anticipate any changes to that draft). Bottom line: the sponsor makes the decision in the first year the lookback rule applies to the plan and then has to live with that decision unless PBGC approves a change. A plan sponsor opts in or out simply by using the desired method on the premium filing for such first year. PBGC wants to do an education campaign for small plans, but not until after the April 30 filing deadline for small calendar-year plans' 2013 premiums.

4. **PBGC's proposed modifications to Schedule MB**. PBGC is proposing modifications to Schedule MB to "require plan administrators of multiemployer defined benefit plans to specify the documentation required regarding progress under the applicable funding improvement or rehabilitation plan. Plan administrators of multiemployer plans in critical status would be required to provide information about the plan year in which the plan is projected to emerge from critical status and, if the rehabilitation plan is based on forestalling possible insolvency, the plan year in which insolvency is expected." Exactly what additional information is PBGC looking for?

   The 5500 Schedule MB already has Yes/No boxes for the actuary to indicate whether an endangered or critical status plan "is making scheduled progress." PBGC wants additional detail on the basis for that response: what the schedule is, how the plan is meeting it. PBGC plans to add a Schedule MB field that asks when the plan is expected to emerge from red- or yellow-zone status. For plans that are in the "forestall insolvency" category, a new field will indicate the anticipated insolvency date. PBGC will also request year-by-year cash flow projections. PBGC staff felt they were asking for things that must already exist in order to prepare the annual status certification.

   The Intersector Group explained that most multiemployer plans don't need to have cash flow projections prepared for purposes of the annual PPA certification – actuaries generally use roll-forward techniques and don't do open-group type projections. For red-zone plans, the "scheduled progress" is commonly measured against the annual standard in the rehabilitation plan. Yellow-zone funding improvement plans don't have annual standards and the test is often applied on a behavioral basis – are the trustees doing the things they need to do for the plan to emerge from yellow zone status. There is a difference between what is reflected in the annual certification and what is reflected in the annual update to the improvement plan. The certification reflects the bargaining agreements currently in effect; the update reflects what must be bargained in the future in order to emerge from red- or yellow-zone status. With respect to "forestall insolvency" plans, many will have year-by-year cash-flow projections in the annual update to their improvement plans. A more appropriate question for the Plan Administrator might be: In the annual update, was insolvency projected, and if so, when? As a first step, PBGC might simply require the actuary to back up the "yes/no" answer with an explanation of how the actuary concluded the plan was or was not "making scheduled progress."

The Intersector Group suggested that the chair of the Academy multiemployer plans subcommittee would be available to the PBGC to discuss the information that is typically available and how the instructions should be worded to make clear the information PBGC is seeking.

5. **Multiemployer program.** What changes is PBGC considering to make the multiemployer program sustainable?

   There is no PBGC proposal and PBGC is not endorsing any specific proposal. PBGC has done analyses of various proposals for the Congressional committees of jurisdiction. At the 2014 Enrolled Actuaries Meeting, PBGC will describe the proposals that have been made and the agency's analysis of those proposals. PBGC's current object is to provide data to promote a robust and informed debate.

   Based on the 2012 Exposure Report, the CBO has predicted that PBGC multiemployer program assets (currently $1.7B) could be depleted in 2021. Since then, PBGC has implemented various changes recommended in the audit of the Pension Insurance Modeling System for the multiemployer program. For example, limiting projected future increases in employer contributions under funding improvement and rehabilitation plans has a big effect on how soon the multiemployer program is expected to run out of money. When this happens, PBGC will pay only what annual premiums will support, which will amount to 5-10 cents on the dollar compared to the PBGC multiemployer guaranteed benefit.

   With no changes, approximately 1.5 million participants are expected to face dramatic benefit cuts, first due to plan insolvencies, and then as a result of PBGC multiemployer fund exhaustion. Certain changes suggested by the National Coordinating Committee for Multiemployer Plans could save plans covering about 600,000 of these participants from insolvency.

   If PBGC were also to partition plans with large numbers of "orphan" participants, with PBGC immediately taking over the orphans at the guarantee level, and the non-orphan participants taking some level of benefit reduction as a quid pro quo, plans covering an additional 800,000 participants could be saved from insolvency. But if PBGC takes over the orphan portions of partitioned plans, it needs additional revenue streams immediately. The multiemployer premium is currently equivalent to about two cents per hour worked (compared to 15 cents per hour for the single-employer program). PBGC would need to increase premiums to 20 cents per hour over 10 years — with a very rapid (non-linear) phase-in, so that the average is estimated around 18 cents per hour over the 10-year period. PBGC is considering whether the premium should be partially a cents-per-hour structure, and/or based on other metrics, versus the current flat-rate-per-participant structure. PBGC recognizes higher premiums could push some plans into insolvency sooner. One possibility is to set premiums at the higher level and give PBGC authority to provide premium relief to certain plans.

PBGC is studying program changes that would increase the maximum guarantee levels. PBGC noted that the single employer guarantee level fully covers benefits for 80% of participants in those plans. PBGC is considering a 55% change to the maximum multiemployer guarantee level that would bring the maximum annual payout to $20,000 for someone with 30 years of service, and would like to have additional tools to protect the most vulnerable populations (disabled and aged retirees). PBGC wants to study how the multiemployer program has worked in practice when plans become insolvent, but getting data is difficult. Only 44 multiemployer plans have become insolvent and all are administered by third parties.

To better publicize the PBGC work on potential changes to the multiemployer program, we suggested PBGC post the Enrolled Actuaries Meeting presentation on their website and consider doing a continuing education session with one of the actuarial organizations.

6. **2013 Exposure Report.** When will it be out?

   The report title is being changed and the content reorganized to improve readability, but the content will be similar to the exposure reports issued in the past. PBGC was hoping to get it out by the Enrolled Actuaries Meeting, but that isn't going to happen. Hopefully it will be soon thereafter.

7. **Cash balance plans crediting actual investment returns.** Proposed IRS regulations would require a cash balance plan crediting actual investment returns to determine the five-year average crediting rate at the termination date using the third segment rate (without regard to actual returns over the prior five years). IRS received many comments indicating this rate was too high. Recognizing that IRS has authority in this area, does the PBGC have a view on what the appropriate crediting rate should be?

   PBGC asked for the five-year average rule in the Pension Protection Act of 2006 because it greatly prefers to lock-in benefit amounts to facilitate the administration of plans that it takes over. PBGC doesn't like having any discontinuity between standard and distress terminations. The Intersector Group observed that carriers have little experience providing annuities in cash balance plan terminations because most plans offer lump sums upon plan termination and the vast majority of participants elect them. Insurers are reluctant to underwrite annuities where participants can elect to take a lump sum (in lieu of an annuity) at essentially any time between the plan termination date and normal retirement age unless the interest crediting rate is a money market or other very short-term rate, consistent with the fixed income returns underlying their general account assets. For plans crediting bond-based rates with maximum margins, the cost to purchase an annuity can be 150% – 250% of the current account balance, because insurers cannot hedge these liabilities. A legislative fix may be needed that would allow a post-termination interest crediting scheme that annuity carriers are willing to underwrite at a price close to the account balance. For plans crediting the actual return on assets, one viable approach would be to permit carriers to continue to credit investment rates of return similar to the basis provided in the pre-termination plan assuming that insurers can find a way to credit such market returns without severely raising the premium (e.g., by investing the premium in a separate account rather than in the general fund). This would seem to be superior to forcing credits at the five-year average of the third segment rate, as provided in IRS proposed regulations.

8. **Variable annuity plans.** Has PBGC developed a procedure to handle the distress termination of a variable annuity plan?

   No. PBGC has very limited experience with termination of variable annuity plans and will handle any distress terminations case by case. PBGC is aware of only one standard termination and one termination that was sufficient for guaranteed benefits but not for all benefits. PBGC analogized the variable adjustment feature to a cost-of-living adjustment (COLA) that is part of the accrued benefit. PBGC does not guarantee future COLA adjustments, except in priority category three, and COLA adjustments in the five years before termination are treated as plan amendments subject to phase-in in priority category four.

9. **Proposed RP-2014 Mortality Tables and Mortality Improvement Scale MP-2014.** The Intersector Group understands PBGC did not contribute data to the Society of Actuaries pension mortality study. PBGC would seem to have one of the largest and most relevant data sets for this purpose. Why did PBGC elect not to participate? Will PBGC be conducting experience studies and providing input to the SOA on the proposed table?

   The Society of Actuaries asked for the data and PBGC said it was willing to share its data, but then no one followed up to collect the data. PBGC is interested in sharing data for mortality studies. However, PBGC does not maintain blue/white collar adjustment data.

   PBGC does its own mortality experience study every five years or so. The most recent study was done in May 2011 to set the mortality assumption for financial reporting. The study used 3.7 million life years of data for 2002 through 2009. At that time, the best fit for the data was the RP-2000 mortality table projected to the midpoint of the mortality study experience period with scale AA and a one-year age setback. For financial reporting, PBGC used RP-2000 combined healthy table projected to the measurement date plus the duration of the liabilities, set back one year (previously PBGC had used a 1-year set-forward).

   See addendum for additional information.

10. **Participant and plan sponsor advocate Connie Donovan.** How can plan sponsors and practitioners best use her?

    Connie has been at PBGC since December. She was previously EBSA’s representative to PBGC, and has held posts at Treasury and as an attorney for municipal and corporate plans. She has a very broad job description and must prepare a report to Congress by year-end. She has already met with many interest groups, including the ERISA Industry Committee, American Benefits Council, Pension Rights Center, union groups, American Academy of Actuaries Senior Pension Fellow, and she will attend the 2014 Enrolled Actuaries Meeting.

To date, many of the requests she has received are in areas beyond her purview (premium rates, repealing Title IV). Her role, assisted by Leslie Kramerich, is to improve PBGC's customer service (for example, trying to expedite requests or improve processes) and pretty much any area of PBGC operations is fair game. Her e-mail is donovan.constance@PBGC.gov.

Addendum to Notes from Intersector Meeting with PBGC on March 12, 2014

Prepared by Society of Actuaries (SOA) and PBGC staff

After reviewing the notes from the March 12, 2014, Intersector meeting with PBGC, SOA and PBGC staff would like to provide some additional information about the data request for the RP-2014 tables as described in item 9 of those notes.

The SOA did send a data request to the PBGC in the 2009-10 timeframe, but the request was not sent to the right contact and, consequently, it did not make it to the PBGC staff responsible for data submissions. Thus, there was no discussion between PBGC and SOA staff about a PBGC offer for their data with respect to the current RP-2014 study.

For the RP-2000 study, the PBGC offered to share its data with the SOA, but a decision was made by SOA's Retirement Plan Experience Committee not to pursue this offer because of concerns about the comparability of the PBGC mortality data for terminated plans with ongoing pension plan data.