



AMERICAN ACADEMY *of* ACTUARIES

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Alice Maroni
Acting Director
Pension Benefit Guaranty Corporation
1200 K Street, NW
Washington, DC 20005

Constance Donovan
Participant and Plan Sponsor Advocate
Pension Benefit Guaranty Corporation
1200 K Street, NW
Washington, DC 20005

Re: Late Retirement Actuarial Equivalence

Dear Ms. Maroni and Ms. Donovan:

The American Academy of Actuaries'¹ Pension Committee wishes to call to your attention an issue with the determination of pension benefits in standard terminations. We understand that the PBGC has taken a preliminary position that we believe runs counter to sound actuarial practice, and that will lead in some cases to inappropriately large retirement benefits. The issue, explained in some detail below, relates to how pension plans should determine, in the case of a participant who retires after his or her normal retirement age (a "late retiree"), the benefit that is actuarially equivalent to the benefit that would have been payable at normal retirement age. In brief, the PBGC is interpreting plan provisions governing actuarial equivalence in a manner that results in benefits that are not actuarially equivalent.

Two benefits are actuarially equivalent if they have equal value, determined under a particular set of assumptions. For a late retiree who is entitled to a benefit that is actuarially equivalent to the normal retirement benefit, there are two adjustments that are always appropriate, and a third adjustment that may be appropriate—and that is the subject of this letter.

The adjustments that are always appropriate are: (1) an increase in the monthly benefit to reflect that the expected payout period is shorter at late retirement than it would have been at normal retirement due to the shorter life expectancy; and (2) an adjustment for interest to reflect the delay in payment of the benefit.

¹ The American Academy of Actuaries is an 18,000+ member professional association whose mission is to serve the public and the U.S. actuarial profession. The Academy assists 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.

The adjustment that *may* be appropriate is an additional increase to reflect that, had the participant not survived until the late retirement date, he or she would have forfeited all (or part) of the benefit. This is referred to as the “benefit of survivorship,” and recognizes that the participant, who had borne the risk of forfeiture at normal retirement age, has survived until the late retirement date and thus no longer bears the forfeiture risk that existed in the intervening years. The inverse of this calculation is arguably more familiar to most actuaries and retirement professionals: it is the reduction for mortality when reducing a future benefit, part or all of which would be forfeited if the participant deferred commencement and died before reaching retirement age. The logic is the same; if a forfeitable benefit is reduced for early retirement, it should be increased for late retirement.

However, the key concept underlying this calculation is that the mortality adjustment is only justifiable *to the extent the benefit is subject to the risk of forfeiture*. A benefit that will be paid even if the participant dies should not be discounted for early retirement (except by interest and the longer expected payment period) nor increased for late retirement (again, except for interest and the shorter expected payment period). Including an additional survivorship adjustment (related to the participant’s survival from normal retirement date to the date benefits begin to be paid) in determining actuarial equivalence in such circumstances would result in a late retirement benefit that is not actuarially equivalent, and would inappropriately increase plan costs. Looked at another way, that would be giving plan participants as a group *both* free life insurance protection in the amount of the present value of the plan’s benefits (as there is no forfeiture on death) *and* enhanced benefits for surviving participants (essentially redistributing the value of the benefits for the people who died to the survivors, even though such value had already been distributed as death benefits).

We understand that PBGC has preliminarily taken the position in the standard termination audit context that such an increase for survivorship is nonetheless required if the plan specifies a pre-retirement mortality assumption to be used in making general actuarial equivalence determinations. Such a provision may exist in a plan because actuarial equivalence determinations need to be made for calculations other than for late retirement, but was never intended to apply to late retirement calculations. This intent may be demonstrated by the plan’s consistent practice of making no such adjustment and by actuarial logic which dictates that no such adjustment should be made. Note also that many plans specify a mortality assumption without distinguishing between pre- and post-retirement mortality periods and we understand that PBGC is not taking the same position in those cases. Plans that specify pre- and post-retirement mortality assumptions separately – rather than implicitly using the same assumption for both – are being singled out for an interpretation that was never intended, never followed in practice, and actuarially incorrect.

Again, note that the inclusion of mortality in an early retirement context accounts for the risk that some of the benefit may be forfeited in the event of the participant’s death (a risk that disappears once payments commence). However, once a participant has reached normal retirement age, *benefits may not be forfeited* except under the Suspension of Benefit rules (in which case, no actuarial increase would apply). To reward a participant for survivorship when there was no risk of forfeiture is to pay the participant an unearned benefit, and to penalize the plan.

Clearly if a plan specifies an actuarial assumption for a particular purpose (be it pre-retirement mortality, mortality generally, or any other purpose), that assumption must be used when *some* assumption for that purpose (e.g., pre-retirement mortality) is required. However, when the

calculation does not call for the use of *any* assumption for that purpose, it would be inappropriate to use an assumption simply because such an assumption has been specified in the plan.

Our concern is that this preliminary PBGC position, if it were adopted as a final position and accepted and applied generally, would run counter to standard actuarial practice and to fundamental concepts of actuarial equivalence. It could lead to plans needing to make many corrections to items such as past benefit payments, contributions, PBGC premium payments and financial accounting disclosures.

The American Academy of Actuaries' Pension Committee appreciates the opportunity to comment on this issue and would be happy to discuss any of these items with you at your convenience. Please contact Matthew Mulling, pension policy analyst (mulling@actuary.org; 202-223-8196) if have any questions or would like to discuss these items further.

Sincerely,

Michael F. Pollack, MAAA, FSA, EA, FCA
Chairperson, Pension Committee
American Academy of Actuaries