Meeting of the American Academy of Actuaries Multiemployer Plans Committee and Representatives from the Department of the Treasury, PBGC, and Department of Labor

October 9, 2020

Notes from Fourth Meeting to Discuss MPRA Application Process

On Oct. 9, 2020, the Multiemployer Plans Committee of the American Academy of Actuaries (the Committee) met with staff representatives of the U.S. Departments of the Treasury (Treasury) and Labor (DOL) and the Pension Benefit Guaranty Corporation (PBGC). The purpose of this meeting was to continue discussions on applications by plans in critical and declining status to suspend benefits or partition liabilities as permitted under the Multiemployer Pension Reform Act of 2014 (MPRA).[1] The meeting was conducted virtually, and representatives from the DOL observed in listen-only mode.

The notes for this meeting, provided by the Multiemployer Plans Committee, are intended to supplement the notes from three prior meetings on the subject with the regulatory agencies, on Feb. 22, 2017, Feb. 23, 2018, and March 14, 2019, which can also be found on the Multiemployer Plans Committee page on the Academy website.[2] The notes for this meeting also clarify the notes from the February 23, 2018, meeting, especially related to the selection of certain actuarial assumptions. Plan sponsors, actuaries, and other professionals may refer to the notes from the prior meetings. For convenience, these notes often refer to prior meetings by their year only (e.g., “the 2018 meeting”).

For convenience, these notes often refer to comments or questions made by “the Committee” or “members of the Committee.” The opinions expressed by Committee members at the meeting, however, are those of the individual meeting participants and do not necessarily represent the official statements or opinions of any board or committee of the American Academy of Actuaries, nor do they necessarily express the opinions of their employers.

Also for convenience, these notes often refer to comments made by “Treasury” or “PBGC.” These notes, however, merely reflect the Committee’s understanding of the current views of representatives from the government agencies; they do not represent official statements or positions of the agencies, and they should not be relied upon by any person for any purpose.

Introduction

Treasury thanked the Academy and the Committee for the ongoing efforts over the past few years to provide the multiemployer pension plan community with information on the process for applying for a suspension of benefits or partition of liabilities under MPRA. Treasury added that

[1] The American Rescue Plan Act of 2021 (ARPA) was signed into law on March 11, 2021. The special financial assistance program under ARPA will likely change the need for plans to apply for a suspension of benefits under MPRA, at least for the next few years.

[2] Multiemployer Plans Committee page: https://www.actuary.org/category/site-section/public-policy/pension/m-employer-pension-plans

it performs a thorough review of each application it receives to determine that it meets the applicable statutory and regulatory requirements, and it performs its reviews in regular consultation with PBGC. Treasury stated the resources expended by a plan in preparing an application can be substantial.

Treasury provided an update on MPRA application activity since the last meeting between the parties. Since March of 2019, there have been four (4) new applications and five (5) re-submissions. Eight (8) suspension applications have been approved, including one (1) involving a partition. Two (2) applications have been withdrawn, and two (2) applications have been denied. There is one (1) application currently under review.

Treasury reported that it has had a number of pre-application conferences, including with plan sponsors pursuing a resubmission. Interested plan sponsors should request a pre-application conference by emailing MPRAinfo@treasury.gov. In this email, the plan sponsor should provide the list of attendees who will be representing the plan and the issues to discuss. Treasury also asks plan sponsors to provide a list of topics in advance of a pre-application conference, so the calls can be more productive.[3]

The Committee thanked the regulators for the continued dialogue on MPRA suspension and partition applications. The Committee identified three objectives for the meeting:

1. To clarify notes from the Feb. 23, 2018, meeting related to actuarial assumptions on investment returns, mortality, and new entrants. Treasury recently denied two applications to suspend benefits, citing certain actuarial assumptions as unreasonable.[4] The Committee is concerned that these denials indicate the 2018 meeting notes are incomplete or misleading.

2. To seek input from the regulators on how to reflect the COVID pandemic in the selection of certain actuarial assumptions for purposes of an application to suspend benefits or partition liabilities.

3. To discuss Treasury's views on the Actuarial Standards of Practice (ASOPs) in developing actuarial assumptions for an application to suspend benefits or partition liabilities. The Committee is concerned with the language in Treasury's denial letters that references the ASOPs when it has concluded that the assumptions selected by the actuary for the applying plan to be unreasonable for the purpose of the suspension application.

Following discussions on these topics raised by the Committee, PBGC provided additional commentary on designing a partition proposal.

[3] Please refer to the 2018 and 2019 meeting notes for more information on pre-application conferences.

[4] On August 11, 2020, Treasury denied the applications to suspend benefits by the American Federation of Musicians and Employers Pension Fund and the Local 807 Labor Management Pension Fund. The applications and denial letters can be viewed at: https://home.treasury.gov/services/the-multiemployer-pension-reform-act-of-2014.

Investment Return Assumptions

The Committee and Treasury engaged in a dialogue about the methodology Treasury uses to evaluate the reasonableness of investment return assumptions, as originally described in the 2018 meeting notes. The methodology relies upon the latest Survey of Capital Market Assumptions published by Horizon Actuarial Services, LLC (the "Survey"), including the distribution of expected returns by Survey respondent.[5]

Specifically, as described in the 2018 meeting notes:

- Treasury considers six (6) benchmark expected returns based on the plan's asset allocation. The first three benchmark returns construct a range of shorter-term investment returns, over a period of up to 10 years. The second three benchmark returns construct a range of longer-term investment returns, for a horizon of more than 10 years.

- The lower end of each range is based on the 25th-percentile expected returns by Survey respondent for each asset class in the Survey, and the upper end of each range is based on the 75th-percentile expected returns by Survey respondent. The midpoint of each range is based on the average assumptions from the Survey for each asset class. All expected returns are geometric. Previous notes state that the 25th- or 75th-percentile returns for each asset class are not necessarily attributable to the same investment firm, and that this methodology effectively excludes expected returns for half of the Survey respondents.

- Treasury then determines the dollar-weighted average returns based on the plan actuary's selected investment return assumptions and compares them to the ranges constructed from the Survey assumptions for the plan's asset allocation.

It is important to note that the 25th- and 75th-percentile returns described refer to varying expectations across the different Survey respondents, not the volatility of investment returns.

Following further discussion with the Committee, Treasury reiterated the following points. While some members of the Committee expressed the view that some points could be clarified, Treasury indicated its view that these points had been clearly stated in the notes from the previous meetings.

- Treasury determines plan's investment return assumption on a dollar-weighted basis, i.e., taking into account the timing of plan cash flows. Treasury then applies two tests to the plan's dollar-weighted return assumption, comparing it to the benchmark returns for years 1 through 10 and for years 11 through the end of the projection period.

- Treasury applies the two benchmark return tests separately. In other words, the benchmark test for years 1 through 10 is separate from the test for years 11 through the end of the projection period. For example, an assumption that is at the lower end of the range of the first test will not offset it being at the upper end of the second test.

[5] In the 2020 edition of the Survey, these distributions are Exhibit 18 and Exhibit 19.

- Treasury does <u>not</u> apply a test that evaluates the selected investment return assumption over the entire projection period. In other words, if an assumption is at (or beyond) the upper or lower end of either of the two ranges of benchmark returns, Treasury will consider it to be unreasonable, regardless of how close the assumption is to the average Survey returns over the entire projection period.

- The 25th- and 75th-percentile ranges of benchmark returns are not safe harbors. In fact, Treasury will likely place additional scrutiny on an assumption that is closer to one end of either of these ranges than it is to the Survey average.

- Treasury stated that an investment return assumption that is equal to the average Survey returns could produce flat returns for years 1 through 10, an increase from year 10 to year 11, and flat returns again for year 11 through the end of the projection period.

The following are additional points discussed by the Committee and Treasury related to investment return assumptions:

- As it had in the 2018 meeting, the Committee restated its observation that Treasury's methodology uses expected returns from the Survey that apply to years 1 through 20 in evaluating assumptions for years 11 through the end of the projection period. As was the case in previous meetings, some Committee members added that they believe this application is a misuse of the Survey.

- Some Committee members expressed concern over constructing separate dollar-weighted investment return assumptions for years 1 through 10 and for year 11 through the end of the projection period. Because dollar-weighted returns take into account the timing of plan cash flows, and Treasury has previously emphasized the importance of the first 10 years of the projection period, some Committee members suggested that it seems unreasonable to employ a dollar-weighted test that specifically excludes the first 10 years. The Committee cited a footnote in the Treasury regulations on MPRA applications that references "dollar-weighted returns over the projection period."

- Treasury responded that it has consistently applied this methodology in reviewing the investment return assumptions of the more than 50 suspension applications that it has received to date.

- Treasury stated that the 25th- and 75th-percentile range of benchmark returns is not intended to mimic the "reasonable range" that previously existed under ASOP No. 27. The benchmark range used in Treasury's methodology is used to consider differences in expected returns among various investment advisors, not the variability of expected returns taking into account investment volatility.

- The Committee raised a hypothetical situation in which Treasury found the investment return assumption in an application to suspend benefits to be unreasonable, but based on the average Survey assumptions, the proposed suspension would be able to demonstrate it meets the applicable MPRA solvency requirements. Treasury responded that in such a situation, Treasury would deny the application.

- As it emphasized in previous meetings, Treasury restated that the purpose of the measurement (as described in ASOP No. 27) is different for a suspension of benefits than for minimum funding requirements. There is no self-correcting mechanism to adjust a suspension of benefits as experience emerges, while minimum funding requirements are adjusted annually based on the experience of the plan. Treasury added that, if an application is to be approved, MPRA requires that the proposed suspension is likely to succeed in enabling the plan to remain solvent for a minimum of the next 30 years. The Committee responded that there are no guarantees a suspension will succeed, even if it uses Treasury's definition of reasonable actuarial assumptions. Rather, reasonable actuarial assumptions may be viewed in the context of a range around the midpoint (50^{th} percentile) of possible outcomes.

Mortality Assumptions

The Committee reviewed the discussion in the 2018 meeting notes on non-standard mortality assumptions. Specifically, the notes could be interpreted to say that adjustments to the standard mortality tables based on plan experience are optional, in other words, that using the standard mortality tables is a safe harbor. Specifically:

> If a plan actuary wishes to make adjustments to the standard mortality tables based on actual plan experience, that experience must be credible. Treasury encourages plan actuaries to consider the recent guidance provided to single-employer plans on using substitute mortality tables, Rev. Proc 2017-55 and Treasury Regulation 1.430(h)(3)-2, when making adjustments to the published mortality tables.

The Committee expressed concern that the 2018 meeting notes need to be clarified, given that a recent denial of an application by Treasury cited mortality assumptions. Given that the denial involved a relatively large multiemployer plan, the Committee asked Treasury if it applies a threshold for experience credibility and when it expects adjustments to standard mortality tables.

Treasury offered the following points for clarification:

- Using a standard mortality table without adjustment is not a safe harbor. There are many standard mortality tables, and Treasury expects the plan actuary to provide justification for the selection of the mortality assumption, including the selection of a standard mortality table, if applicable. The justification should take into account the plan's demographic characteristics and plan experience, where credible.

- The justification for the mortality assumption should be based on plan experience, except for plans that do not have sufficiently credible experience. Treasury also advises the plan actuary to reflect mortality experience weighted by benefit amounts (i.e., amounts-weighted experience) unless use of unweighted experience is documented and justified as reasonable by the plan actuary.

- For example, a plan's mortality experience may have a "barbell" distribution, with participants at the high end of the range of mortality rates having generally low benefit amounts. The plan's amounts-weighted experience would show significantly lower mortality rates than its unweighted experience. In this case, it would not be reasonable to select a standard mortality table based on unweighted plan-specific experience.

- If plan mortality experience shows a consistent pattern of gains or losses, Treasury is more likely to scrutinize the selected mortality assumption.

Treasury added that, as indicated in the 2018 meeting notes, any adjustments to the standard mortality tables must be based on credible plan experience. Treasury does not have a specific threshold for determining credibility, beyond what is described in the guidance to single-employer plans in Rev. Proc. 2017-55 and Treasury Regulation 1.430(h)(3)-2. Treasury stated that it would be appropriate to reflect plan experience that was either partially credible or fully credible.

New Entrant Assumptions

The Committee noted that the 2018 meeting notes amended the discussion in the 2017 meeting notes on survivorship bias in developing an assumption for future new entrants. Given a recent denial by Treasury, the Committee asked if the notes should be further clarified to address the assumption of inactive participants returning to active service.

Treasury indicated that in developing assumptions regarding future new entrants, actuaries should consider whether plan experience shows new entrants with prior service. In the case of the recent denial, the selected new entrant assumption did not take into account the demographic characteristics of the significant number of inactive participants returning to active covered employment.

The Committee asked if expectations for inactive participants returning to active covered employment could be incorporated into the termination rate assumption, i.e., making an adjustment to the termination rates to account for inactive participants returning to active status. Treasury indicated its preference for explicit assumptions over implicit assumptions, as well as clear documentation and justification of the selected assumptions.

Impact of COVID Pandemic on Actuarial Assumptions

The Committee discussed with Treasury what additional documentation and justification plan actuaries need to provide on actuarial assumptions for future contribution levels, given the uncertain impact of the pandemic.

Treasury noted that its process for reviewing assumptions on contribution base units and withdrawal liability payments has not changed, and that it always takes into account the facts and circumstances unique to each plan. Assumptions that deviate from plan experience need more justification. The pandemic is another factor in developing the assumption. The impact of the pandemic on plan's industry is an important consideration.

In the end, Treasury expects a well-thought-out, well-supported narrative that provides a basis that is reasonable at the time of submission. Plan sponsors and actuaries should expect follow-up questions from Treasury related to the expected impacts of the pandemic on work levels, contributions and/or withdrawing employers. Treasury may request audited financial statements for significant participating employers, and will sign non-disclosure agreements with those employers if needed.

Treasury added that it can provide guidance to plan sponsors and actuaries in pre-application conferences, but it cannot sign off on any particular assumption as reasonable. The Committee asked why Treasury could not agree to a particular assumption or methodology prior to the application, if the plan provided all required documentation and justification in advance. Treasury responded that it cannot pre-approve any individual actuarial assumption because it reviews the application as a whole; that is, the actuarial assumptions must also be reasonable in the aggregate. Treasury noted the rigor of its review process.

The pandemic has contributed to market volatility in 2020. The Committee asked if Treasury is using the 2020 edition of the Horizon Survey when reviewing investment return assumptions, given the recent drop in interest rates and possible changes to future return expectations. Treasury reiterated that it continues to apply its adopted methodology using the most recent version of the Survey.

Applicability of Actuarial Standards of Practice

The Committee discussed with Treasury how, when it denies an application to suspend benefits on the basis of an unreasonable actuarial assumption, the denial letter makes reference to the Actuarial Standards of Practice. The Committee is concerned how, if Treasury cites the ASOPs and then determines a selected actuarial assumption is unreasonable, it implies the plan actuary did not follow the ASOPs. The Committee added that the ASOPs themselves describe how actuaries must use professional judgment in selecting assumptions, and different actuaries may arrive at different assumptions, both of which may be considered to be reasonable.

Treasury responded that references to the ASOPs in denial letters do not suggest or imply that the plan actuary failed to follow the ASOPs. Treasury noted that in most cases, the ASOPs precede the passage of MPRA. Nevertheless, Treasury refers to certain principles defined in the ASOPs when reviewing actuarial assumptions. Specifically, in order for an assumption to be reasonable: (1) it must be appropriate for the measurement; (2) it must take into account relevant historical and current economic data; and (3) it must have no significant bias.

The Committee suggested that Treasury make a clear declaration in its denial letters that the letters must not be interpreted as saying the plan actuary did not follow the ASOPs. Rather, to the extent Treasury cites the ASOPs in its denial letter, it does so only to reference general principles described in the ASOPs it applies when reviewing selected actuarial assumptions. The Committee added that Treasury should clarify in its denial letters that it is not applying the ASOPs, but rather a different standard for determining whether an assumption is “reasonable” under the statute and regulations related to applications for suspension of benefits.

Treasury received the Committee’s feedback and noted it will review and consider revising the language in the denial letters.

Partition Design

PBGC explained to the Committee that when Treasury reviews an application to suspend benefits under MPRA, it is bound by statutory notice and comment requirements that effectively prohibit any change to the application after it is submitted. PBGC, however, is not bound by such requirements when it reviews applications for partitions. For that reason, PBGC has the flexibility to work with plan sponsors to alter the design of a proposed partition after the application is submitted. PBGC noted that half of the partition applications it has reviewed to date have undergone some modification to the proposed partition design after the application was submitted.

PBGC encourages plan sponsors to seek pre-application conferences on partitions, especially for guidance on the non-impairment test.[6] PBGC noted that a plan applying for a partition must undergo a concurrent review by Treasury of its application for a suspension of benefits. Nevertheless, a change in the design of the proposed partition after the application is submitted does not pose a problem in PBGC's point of view. Changes during an application do not necessarily require a new partition application but may require a new suspension application.

[6] The non-impairment test is the statutory requirement that PBGC must certify to Congress that the partition would not impair its ability to meet existing financial assistance obligations to other plans.