AMERICAN ACADEMY *of* ACTUARIES

May 4, 2010

Senator Johnny Isakson
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Senator Benjamin Cardin
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RE: Multiemployer Pension Plans Funding Relief Provisions Included in H.R. 4213

Dear Senator Isakson and Senator Cardin:

The Pension Committee of the American Academy of Actuaries[1] and its Multiemployer Plans Subcommittee respectfully request your consideration of comments regarding the multiemployer pension plan relief provisions of your amendment to H.R. 4213, which was included in the bill as passed by the Senate on March 10, 2010, but has not yet been enacted nor addressed by the House. We thank the Senators for their efforts in support of strengthening retirement security and the ability of employer and employee groups to continue support of these important programs.

To the extent that these or similar multiemployer provisions of your amendment will be included in a future bill, we are concerned that certain aspects could be misinterpreted as currently written and offer suggestions as to how they might be clarified.

- To enable plans to take advantage of the relief quickly, the legislation should clearly indicate the manner in which the "net investment loss" is determined and how the special year amortization bases should be established.
- The number of years over which the relief provision will be amortized should be clarified as starting at 30 years, reducing by one for each subsequent year that the relief is allotted.
- The relief raises timing and retroactivity questions related to the development and amendment of funding improvement and rehabilitation plans, as well as the interaction of the relief with previously issued certifications. These issues need to be addressed.

Our detailed comments follow:

[1] The American Academy of Actuaries is a professional association with over 16,000 members, whose mission is to assist public policymakers 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.

A. Portion of Net Investment Loss to be Granted Relief

The bill provides that a multiemployer plan "may treat the portion of any experience loss or gain attributable to net investment losses incurred in either or both of the first two plan years ending after Aug. 31, 2008, as an item separate from other experience losses.…" The bill language further provides that net investment losses "shall be determined in the manner prescribed by the Secretary of the Treasury on the basis of the difference between actual and expected returns.…"

Practical considerations

We think it appropriate, as a matter of practicality, to consider the investment experience of plans and consider what relief options the plans would choose. The bill allows for the 30-year[2] amortization of losses or gains at the plan's option, but plans would not choose to extend the amortization of a gain. Given the periods for which relief is offered it is likely that most plans would be able to amortize only one year's net investment loss (NIL) (as discussed below). The exceptions would be plans with years beginning July through November, where two years of net losses would be more likely. Thus the majority of plans will only consider one year's net loss. For purposes of this letter, we will assume there is only one year of net investment loss for which relief is applicable; this is herein referred to as the "2008 NIL."

The first area in need of clarification is the definition of "net investment loss." For funding purposes, actuaries recognize gains and losses arising from investment experience using actuarial asset values. The actuarial asset value is designed to dampen the volatile nature of the investment markets so that the plan sponsor is not faced with widely fluctuating funding requirements. Actuaries use a number of different methods for determining the actuarial value of plan assets but in essence each of the methods recognizes the market gain or loss over a period of time[3]. However, with all methods, at some point in the calculation a net investment result is calculated as the difference between the fair <u>market</u> value of assets and the expected asset value[4] on the valuation date. It is the difference between the actual and expected market values that should form the net investment loss to which the amortization relief is afforded. Because this amount is recognized over a period of time (due to the use of an actuarial value of assets) the impact of the net investment loss and the relief afforded by the bill will extend over more than one annual valuation. This is fully consistent with our reading of the bill language but should be clarified.

Constraints on the actuarial value of assets

Under all actuarial asset valuation methods, the final result is constrained by law so that it is not less than 80 percent of market value and not more than 120 percent of market value. (A separate part of the bill would allow the use of 130 percent of market value instead of 120 percent for certain years.) If a constraint applies at any valuation date, its effect is to recognize more of the net investment loss (NIL) at that valuation than would be recognized if the actuarial valuation

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[2] We will refer to the amortization relief as 30-year although, as drafted, the amortization periods are all shorter than 30 years. Comments on this issue follow later in this document.

[3] e.g. in one common method the investment gain or loss is phased-in at the rate of 20 percent per year over five-years.

[4] The expected asset value is the amount of assets the plan should have on the valuation date if it the prior valuation assumptions had come to pass. Depending on the actuarial method the expected value may be based either on the market value of assets or on the actuarial value of assets at the prior valuation date. For most plans the assumed rate of return on assets is in the range of 7.0 percent to 7.5 percent per annum.

method were applied without the constraint. Indeed, without constraint there would be a steady recognition of the 2008 NIL, but with constraint the pattern of recognition is disrupted and it is very possible to find a pattern of higher net loss recognition in the initial year, followed by a year of recognized gain when the constraint ceases to apply due to an investment gain occurring after the 2008 NIL. To the extent this gain results from the undoing of the constrained pattern of recognition of the 2008 NIL one might expect it to be amortized using the 30-year amortization, but relief would be more effective if it is treated as an ordinary gain and amortized over 15 years. Thus, to obtain the relief it appears the law intends to provide, actuarially recognized losses due to the 2008 net investment loss (NIL) should get 30-year amortization and all actuarially recognized gains should retain normal 15-year amortization with limitations to ensure that the amount subject to the 30-year amortization rule never exceeds the 2008 NIL.

Loss recognition for funding purposes

A related problem caused by constraints is how to determine which losses are included for purposes of accelerated recognition. Because actuarial valuation methods gradually recognize market value investment experience, there is more than one year of asset gain or loss being partially recognized at each valuation, although the magnitude of the 2008 NIL dominates the other gains and losses. If the constraint applies, how is the loss recognition (defining the portion entitled to extended amortization treatment) apportioned between the various years? We suggest two ways to accomplish this:

1. Allocate solely the NIL by recognizing the portion entitled to extended amortization treatment over a fixed number of years, while leaving the actual pattern of recognition of gains and losses unchanged. Regulations could indicate that in no event could the deemed number of years over which the relief (extended amortization) is allocated be less than the smoothing period. For a five-year smoothing method, cumulatively 20 percent per year would be permitted—e.g., for a 2008 NIL (market value loss) and five-year smoothing, 20 percent of the loss could be amortized over 30 years starting in 2009, another 20 percent could be amortized over 29 years starting in 2010, etc. However, because of the constraints discussed above, there should be some acceleration in the early years. Perhaps in a year that the constraint applies, that amount of adjustment could be added to the standard ratable amount. Following the example above, if the corridor constraint applies at 1/1/2009, with the adjustment representing 30 percent of the 2008 NIL, then 30 percent of the 2008 NIL loss would be deemed included in the 1/1/2009 recognition amount, for a total of 50 percent. Then nothing would be recognized for 1/1/2010 (unless the corridor applies again), only 10 percent could be deemed recognized at 1/1/2011, and then the remaining two 20 percent portions are recognized at 1/1/2012 and 1/1/2013. An offsetting credit (gain) amortization base (over 15 years) might need to be established at each recognition point, to bring the funding standard account (which demonstrates cumulative compliance with minimum funding standards) into balance.

2. Implement a pool approach, under which all unrecognized investment gains and losses would qualify for extended amortization as they are incorporated into the funding standard account. The 2008 NIL would serve as the starting value of a pool, to be drawn down over time as the annual valuation calculates an investment loss included on an actuarial basis, taking into account the effect of any corridor constraints. If there is a net

unrecognized investment loss prior to the 2008 NIL the portion of the actuarial loss arising at the first post-2008 NIL valuation allocated to the 2008 NIL would be greater than the first method, while if there is a net prior unrecognized gain before the 2008 NIL then the opposite would be the case.

While there are certain actuarial asset valuation methods[5] that could directly and simply apportion the 2008 NIL, the suggestions above would work for all actuarial smoothing methods.

B. Number of Years in the Amortization Period

Within the provisions of Senate-passed H.R. 4213, there is language that appears to, in effect, limit the amortization period for the investment losses to 29 years. It is our understanding that the language under this section may have been modified to prevent extension of the relief beyond a 30-year period by setting an ultimate year in which the investment losses are fully recognized. Given that other provisions in the legislation are centered on a 30-year period, it is unclear whether the 29-year period was an oversight or intentional.

The new language under ERISA §304(b)(8)(A) would allow the portion of any experience loss or gain that is attributable to investment losses incurred in either or both of the first two plan years ending after Aug. 31, 2008, to be recognized as a separate item from other experience losses. This separate loss would be recognized in the funding standard account in equal annual installments until fully amortized over the period

(I) beginning with the plan year in which such portion is first recognized in the actuarial value of assets and

(II) ending with the last plan year in the 30-plan year period <u>beginning</u> with the plan year in which such net investment loss <u>was incurred</u>.

The language appears to effectively provide for a maximum amortization period of 29, not 30 years. For example, assume a calendar-year plan experienced an investment loss during the 2008 plan year, and the loss would first be recognized in the actuarial value of assets in the plan year beginning Jan. 1, 2009. The language appears to require the loss to be fully amortized by the end of the 30-plan-year period beginning with the 2008 plan year in which the loss "was incurred." Therefore, the final amortization payment occurs in the plan year beginning Jan, 1, 2037, or over a 29-year period.

It could be argued that the use of the word "incurred" in (II) above references the 2009 plan year as the starting point for the 30-year period, effectively allowing for recognition of the losses over a maximum of 30 plan years. However, similar use of the word "incurred" in ERISA §304(b)(8)(A)(i) seems to indicate that the language refers to the 2008 plan year. The ending year should be clarified.

[5] While there are only a limited number of actuarial asset valuation methods that qualify for automatic approval under IRS procedures, several plans have alternative methods that (either explicitly or implicitly) take many years to fully recognize a gain or loss in operation.

C. Issues Surrounding Effective Dates of Relief

The proposed legislative relief raises questions related to prior certifications, the development of funding improvement and rehabilitation plans, and the interaction of the relief with previously issued certifications. These issues need to be clarified in both issuing certifications and developing or amending funding improvement and rehabilitation plans.

The bill describes the effective dates for the multiemployer pension relief provisions to take effect on the first day of the plan year ending after Aug. 31, 2008, except that any election made under this section that affects the plan's funding standard account for the first plan year beginning after Aug. 31, 2008 shall be disregarded in applying the provisions of ERISA Section 305 and IRC Section 432.

We understand this language to mean that a plan may not take into account any changes to the funding standard account resulting from the relief in order to change the PPA'06 status certification for the first plan year beginning after Aug. 31, 2008. For example, a calendar year plan that was certified as critical for the 2008 or 2009 plan year due to a looming funding deficiency would not be eligible to re-certify the plan's 2009 zone status if the relief delayed the deficiency beyond the period that would require a critical status certification.

There are a number of practical questions related to the effective date of the relief and the interaction with prior certifications. We describe them below:

1. Are the restrictions for use of the relief related to ERISA Section 305 applicable to established funding improvement or rehabilitation plans, or do the restrictions only apply to certifications? For instance, suppose a plan formulated a rigorous rehabilitation plan prior to the relief (requiring substantial benefit reductions and/or contribution increases). After electing the relief, may the plan sponsor amend the rehabilitation plan retroactively to modify the schedules issued to bargaining parties that adopted these more rigorous schedules?
2. Does the relief allow for re-certifications? Many actuaries believe that there is no provision in the Pension Protection Act of 2006 (PPA) for re-certifying a plan's status. However, many plans that have already been certified for the *second* plan year beginning after August 31, 2008 (for example, the plan year beginning January 1, 2010) may be interested in re-certifying their status, reflecting the relief, and the ability to do so should be clarified.
3. If re-certifications are permissible, how will the new zone status interact with actions taken as a result of previously-issued certifications? Examples include:
    a. Reductions in adjustable benefits already in place for critical status. Must these reductions be reinstated?
    b. Previously imposed employer surcharges for critical status. Should these surcharges be refunded?

   c. The suspension of "non-annuity benefits" for a critical status plan. Should affected participants be allowed to retroactively revise their elections?

   d. Imposition of default schedules on bargaining agreements beyond the 180-day threshold. Should a revised schedule (if any) be applied?

   e. Notices and other administrative issues. Will any provisions be made for plan sponsors who need time to consider election of the relief provisions, with regard to the annual funding notices under ERISA Section 101(f) or notification of status under ERISA Section 305(a)(3)(D)?

4. It should be clarified that plans may ignore relief for purposes of the PPA certification yet utilize the relief in the development of the funding improvement or rehabilitation plan. For example, suppose a plan would be certified as in critical status for the 2010 plan year without the relief but would be certified as in endangered status if the relief is elected. The plan sponsor believes that in order to save the plan, reductions must be made to the plan's adjustable benefits. The plan should be able to retain critical status for 2010, reduce adjustable benefits, and subsequently elect the relief to incorporate the extended amortization of the 2008 losses into the plan's rehabilitation plan.

We would be happy to discuss any of these items with you at your convenience. Please contact Jessica M. Thomas, the Academy's pension policy analyst (202-785-7868, thomas@actuary.org) if you have any questions or would like to discuss these items further.

Sincerely,

John H. Moore, FSA, MAAA, EA, FCA
Chairperson, Pension Committee
American Academy of Actuaries

Cc: Senator Tom Harkin, Chairman, Senate Committee on Health, Education, Labor, and Pensions
Cc: Senator Michael Enzi, Ranking Member, Senate Committee on Health, Education, Labor, and Pensions
Cc: Representative Sander M. Levin, Chairman, House Committee on Ways and Means
Cc: Representative Dave Camp, Ranking Member, House Committee on Ways and Means
Cc: Representative George Miller, Chairman, House Committee on Education and Labor
Cc: Representative John Kline, Ranking Member, House Committee on Education and Labor