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Retirement and Welfare Plan Actuaries

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Positives From 2018 Enrolled Actuaries Meeting – Spring 2018

The 43rd Annual Enrolled Actuaries Meeting was held in Washington, DC during April 2018. The Meetings are sponsored by the professional and federal governmental agencies overseeing retirement and employee welfare plan regulatory matters. Enrolled Actuaries from across the nation regularly attend these Meetings to obtain their continuing educational credits.

One session at the Meeting focused on an Issue Brief from the American Academy of Actuaries titled The Pension Protection Act: Successes, Shortcomings, and Opportunities for Improvement that appears on the Internet. The Brief is very positive for defined benefit plan sponsors because recognition of the issues begins the process of regulatory mending. The Pension Protection Act of 2006 (PPA) has further discouraged the formation and continuation of defined benefit pension plans despite their being the least-cost source of retirement benefits. Following are some key concepts from the Brief, but are neither limited to the Brief nor necessarily representative of positions in the Brief.

Wrong timing – PPA assaulted pension funding at the worst possible time. PPA tied the minimum funding valuation interest rates for ERISA covered single employer plans to corporate bond rates that fell 50 basis points from January 2008 through January 2012, and fell another 125 points from January 2012 through December 2017 to increase minimum funding requirements. Equity markets dropped 40% from September 2008 through February 2009 as a result of the 2008 market crash, decimating plan assets. Previously well funded pension plans were suddenly underfunded with greatly increased minimum funding requirements leaving many employers unable to fund their plans. The Federal Reserve's easy money policies to stimulate economic growth have held interest rates abnormally low since 2008. Some investment portfolios have yet to recover their 2008 losses. Low interest rates have also held the fixed income portions of investment portfolios below their expected market values.

Retreat from original PPA requirements – the 2008 equities market crash and the Federal Reserve's forced low fixed income interest rates resulted in much lower than anticipated segment interest rates for minimum funding and Lump Sum Distribution (LSD) present values. Beginning in 2012, Congress enacted "Funding Relief" measures linking minimum funding valuation interest rates to 25-year average corporate bond rates, the effect being to increase valuation interest rates to lower minimum funding requirements. Funding Relief delayed a return to historical funded status standards to more rapidly deteriorate many plans' funded status, increasing their risk exposure to events that may force benefit payments before they are expected. The abatement of the original PPA interest rate requirements left many plans less well funded than they would have been under the original ERISA funding requirements. To quote the Brief, the current requirements "... can create a disconnect between the behavior of a plan's assets and liabilities ...".

LSD and PBGC liabilities forgotten – the Funding Relief provisions do not apply to LSD present values and accrued benefit present values for PBGC Premium purposes. Consequently, LSD present values are abnormally high compared to minimum funding present values to more rapidly deteriorate a plan's funding position as LSDs are distributed. An unexpectedly large unfunded liability can mature prematurely when a less well funded plan is forced to terminate. Unfunded liabilities for PBGC covered plans are much greater under PBGC's separate set of lower valuation segment interest rates that may increase PBGC Premiums. The minimum funding requirements do not reflect a plan's true funded status.

Limited employer discretion – under ERISA, plan sponsors elected one of its approved funding methods, the valuation assumptions for minimum funding, and LSD present value assumptions based on the

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actuary's recommendations. LSD present value assumptions were mandated under the Retirement Protection Act of 1994, but were manageable. PPA removed all employer discretion for the selection of a funding method and valuation assumptions that meet its objectives. PPA's single permitted funding method with strictly required amortization periods for past service liabilities usually do not fit an employer's specific situation and objectives. The awkward PPA funding method makes it impossible to determine expected long-term funding requirements without a separate valuation under an ERISA level funding method that smoothes adverse experience deviations and enables long-term planning.

Unnecessary complications - PPA imposes a 3-segment interest rate structure for pension valuations based on full yield curve interest rates. The segments are divided into years 0 through 5, 6 through 20, and 20 and after. The current interest rate environment exhibits lower short term interest rates with rates gradually increasing longer term. Each plan participant is valued at a different interest rate depending on his expected remaining years to retirement. Each segmented interest rate structure has a single Effective Interest Rate that produces the same present value for a valuation as under the segment rates. A single valuation interest rate could be applied effectively based on the yield curve, and would be much easier for employers to understand. In addition, PPA requires different funding status measurements for different purposes making a plan's financial condition ever more blurred. The Brief suggests these requirements be simplified, as simplicity is a fundamental concept of a valid funding procedure.

Other inconveniences – PPA added several administrative requirements creating time consuming computations with little added value and increased exposure to errors and missed deadlines. PPA's application of Funding Balances, i.e., accumulated contributions exceeding minimum required contributions, previously referred to as a Credit Balance should be replaced by the pre-PPA Credit Balance rules. PPA imposes benefit restrictions that limit full LSDs for plans less than 80% funded as determined under the Funding Target Attainment Percentage (FTAP) measurements that are clumsy, requiring timely advance benefit restriction notices to plan participants when the expected FTAP falls below 80%. The FTAP's blurred timing requirements permit manipulation of the notice requirements in a changing asset and contributions environment. PPA replaces the ERISA Summary Annual Report (SAR) with an Annual Funding Notice (AFN) with duplicate information for PBGC covered plans. The AFN adds administrative time and expenses, and is not nearly as understandable as the SAR requirements. And, IRS has not always provided timely PPA guidance leaving plan sponsors little time to act rationally before the rules are effective.

PBGC matters apart from the Brief – the Kelly/Kind Premium Bill before Congress would reduce PBGC Premiums for plans covering 500 or fewer participants. But, the "Keep Our Promises Act" (H.R. 2412 and S. 1076) would permit PBGC to transfer assets from the single employer surplus to a new multiemployer program. PBGC now projects a \$9.6 billion surplus by 2026 under conservative assumptions for single employer plans. PBGC's multiemployer plan insurance program had a \$65.1 billion deficit in 2017, and is projected to run out of money by 2025. Multiemployer plans are under much less stringent funding requirements than single employer plans, and many provide overly generous benefits that add to labor costs. Smaller employers pay a disproportionate share of PBGC premiums because they are less likely to collect insurance benefits. Write your Congressman to object!

Employer defaults to Section 401(k) and IRA-type arrangements as the path of least resistance these past few years is producing massive waves of retirees with little retirement income security. This evolving national emergency must be addressed to avoid a taxpayers' burden for indigent retirees.

Please call or e-mail any comments.