PENSION RIGHTS CENTER

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March 28, 2016

The Honorable Jacob J. Lew
Secretary of the Treasury
Department of the Treasury
MPRA Office, Room 1224
1500 Pennsylvania Avenue, NW
Washington, DC 20220
Attn: Deva Kyle

Submitted electronically via http://www.regulations.gov and by e-mail

Re: TREAS-DO-2015-009 Supplemental Comments Responding to March 1, 2016 letter on the Application to Reduce Benefits Submitted by the Central States, Southeast and Southwest Areas Pension Plan

Dear Secretary Lew:

On March 1, 2016, Central States, Southeast and Southwest Areas Pension Plan ("Central States") responded to comments submitted by several organizations, including the Pension Rights Center, that had previously filed comments opposing the Central States' application to suspend benefits of certain plan participants. This letter addresses various points raised in the Central States' comments. The letter is divided into three sections. The first section notes that the 7.5% assumed rate of return on investments used by Central States' actuary to predict future solvency is not reasonable, given the purposes of MPRA and the circumstances of the Central States plan. The second section raises concerns that the application's description of its actuary's stochastic modeling is inadequate for purposes of meaningful Treasury Department review and that the modeling, to the extent it is described in the application and Central States' March 1 comments, is based on improper assumptions and methodology. The third section focuses on flaws in the plan sponsor's process in distributing benefit cuts among participants, flaws that result in an inequitable distribution of benefits cuts.

I. 7.5% is an Unreasonable Rate-of-Return Assumption for Purposes of the Section 432(e)(9)(c)(i) Projection

Section 432(e)(9)(c)(i) imposes as a condition of a benefit suspension that "the plan actuary certifies that the plan is projected to avoid insolvency within the meaning of section 418(e), assuming the suspensions of benefits continue . . . indefinitely." Proposed regulations require that the certification be based on both a deterministic projection using reasonable actuarial assumptions and on stochastic modeling reflecting variance in investment returns in which the probability of avoiding insolvency exceeds 50%. For purposes of the deterministic projection, the plan's actuary assumed a 7.5% return on investment. A number of comments noted that

this assumption was unduly optimistic, that the return assumption is at the upper-end of industry projections of future financial return on portfolio constructions similar to that of Central States (over 10 and 20-year time horizons); is higher than the plan's own investment performance over the last decade; and ignores the reality that the plan's benefit annual payments exceed the sum of projected contributions, withdrawal liability payments, and investment income and thus is unusually sensitive to early below-assumption predictions.

Central States' March 1 comments defend the 7.5% assumption on several bases. First, and central to Central State's defense of the assumption, is that an actuary may select as a reasonable assumption an assumption from the optimistic end of a range of "reasonable" assumptions. ("Courts", Central States tells us, "have long recognized that, where ERISA requires actuarial determinations to be reasonable, the standard is satisfied as long as the actuary's methods and assumptions fall within a reasonable range.") Central States notes that many multiemployer plans, including one of the sister plans to Central States, has used an even higher assumption and that 7.5% is not an unusual funding assumption for multiemployer plans.

Central States, however, misses a critical and first principle: that an assumption is only reasonable if it is "appropriate for the purpose of the measurement." Actuarial Standards of Practice, 3.6a (September 2013). Congress, in enacting MPRA, conditioned benefit suspensions on the plan being projected to avoid insolvency after the benefit cuts. This MPRA requirement provides participants meaningful assurance that the plan will not be forced to request further benefit cuts and similarly ensures that the plan is likely to avoid future insolvency, an important purpose of MPRA's sanctioning of benefit reductions.

Central States argues, in effect, that because a 7.5% return assumption may be within a reasonable range of assumptions for one purpose—minimum funding or disclosure—it is also reasonable for an unrelated purpose—providing meaningful assurance of future plan solvency following the benefit cuts. However, the fact that an assumption may be reasonable for one type of measurement does not make it reasonable or appropriate for a different type of actuarial measurement. An assumption may have a disabling optimistic bias for one use but not for another use.

In the case of funding, for example, the effect of not meeting actuarial predictions is generally not fatal: the employer(s) can contribute more to the plan in the future to correct a resulting funding shortfall. In the case of financial disclosure, those relying on the disclosure can take into account their own views of future investment performance in assessing the value and meaning of the disclosure.

In contrast, the consequence of variance between experience and an assumption for a MPRA solvency projection is that the plan sponsor will have to make further benefit cuts or that the plan will become insolvent, outcomes that MPRA and its solvency test are designed to make unlikely.

Here it is also highly relevant that Central States contends that contributing employers are not able or willing to make contributions in excess of the current scheduled contributions, so the

plan's failure to realize a 7.5% return will almost certainly mean that the plan will fail or that additional benefit cuts will have to be made.

Moreover, Central States projected cash outflows (benefit payments, administrative expenses, and any annual negative return on investments) exceed projected inflows (contributions, withdrawal liability payments, positive return on investments). As such, returns that fall short of expectations in early years will require heroic returns on the diminished asset base to recover. And Central States concedes that returns are expected to be lower over the next decade ("It is true that most investment experts believe that asset returns will be lower over the short term than they will be over longer time frames than in years following") yet the acknowledged impact of lower early returns on a decreasing asset base does not appear to have played a meaningful role in the actuary's selection of the rate-of-return assumption.

It should also be said that the plan's negative outflow means that the plan will not be able to balance any negative rates of return by purchasing new assets at lower market prices, a long-term ameliorative against the effects of plan losses for plans whose annual cash inflows exceed annual cash outflows.

Given these factors, individually and in combination, assuming a 7.5% rate of return on investments for the purpose of the MPRA plan-solvency projection is unreasonable.

II. Issues with Respect to Central States Stochastic Modeling

The proposed regulations require the application to reflect more than a 50% probability that the plan will avoid insolvency throughout an extended period (of at least 30 years) based on stochastic modeling reflecting variance in investment return. The application indicates that under the plan has a 50.4% chance of avoiding insolvency under such modeling at the end of 50-year period. The application's description of the modeling is provided in three short paragraphs and two charts on pages 21 and 22 of Item 7.

The description of the stochastic modeling in the application and Central States' March 1 comments raise serious issues about the reliability and reasonableness of the stochastic modeling used by the plan. Moreover, the concerns that we raise, in combination with the brevity of the description of the modeling, suggest that Department should request further information about the modeling from Central States' actuary and examine the modeling closely.[1] (We note that the modeling combines all domestic equity into a single asset class and assumes a static asset allocation over a 50-year period.) Our other concerns are the following:

1. The stochastic modeling appears to assume a uniform expected rate of return for all years in the modeling, even though Central States in its March 1 comment letter agrees that asset returns will be lower over the short term than the long term. The Central States March 1 comments implicitly defend this concededly unrealistic methodology by asserting that "actuaries rarely use different assumptions for expected investment returns over various

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[1] For example, we believe that the Department should obtain additional information from Central States concerning the relationship between the rate-of-return assumption used in the plan actuary's deterministic projection and the blended rate of return used for the stochastic modeling.

periods for multiemployer plan valuations or projections." The stochastic modeling of future solvency with a uniform-rate-of-return input, however, is particularly inappropriate for a plan with a declining asset base, where early low returns would have significant adverse impacts on potential future solvency, even if, as Central States contends, use of a uniform expected return number is common among actuaries for non-MPRA purposes and reduces some modeling complexity. Such modeling distorts reality.

2. The proposed regulations indicate that the plan's solvency must be determined over an extended period, which the regulations provide must be at least 30 years. The plan chose, however, to do its projections over a 50-year period, a choice we suspect had two related purposes. First, because of the increased difficulty of predicting rates of return into the distant future, the longer the period of projection, the more deference must be accorded the actuary's judgment. The actuary is thus less constrained in selecting an optimistic rate of return for a 50-year period. Second, the effects of the higher rate of return were then distributed evenly over the entire period of the projection, thus puffing up the expected rate of return in earlier years over likely returns for those early years. The effects of this distortion on a plan with a declining asset base can be profound.

III. Distribution of Benefit Suspensions

MPRA provides that the plan sponsor's benefit suspensions must be equitably distributed and provides a non-exclusive list of considerations that the trustees may take into account. The Secretary of the Treasury, in reviewing determinations made by the plan sponsor, must accept the plan sponsor's determination unless the Secretary finds that the determinations were clearly erroneous. We have noted in previous comments that the plan trustees, being appointed by the union (whose membership does not include retirees or most deferred vested participants) and the contributing employers, operate under conflicts of interest and that this should be a factor that is taken into account in determining whether the plan sponsor's determinations are clearly erroneous. In our previous comments we also identified some categories of benefit suspensions that in our view failed the equity criteria, most egregiously the severe reductions for deferred vested employees with fewer than 20 years of service and for participants who accepted subsidized early retirement benefits. We noted in particular the harshness and the irrationality of the cuts for deferred vested employees—a single extra year of service can result in some cases in a 100% increase in benefits. There is the further fact that a deferred vested employee who returns to service after the benefit suspensions will have substantially lower benefits than a colleague with the same number of years of service. The effective elimination of early retirement subsidies for retired employees ignores the lost pension accruals such retirees would have earned had they foregone early retirement, the lost earnings opportunities that could have facilitated increased personal savings, the longer period of retirement, and their expectations about benefit security based on the funded status of the plan at the time of retirement.

Any decision that relies on a decision-maker's broad discretion requires that the process relied upon be rigorous, fact-based, thorough, and fair. The trustees' decision-making on benefit distributions, however, sometimes relied on questionable speculation rather than on actual

facts, failed to consider questions that bear directly on the equity of the suspensions, and failed to provide meaningful input from retirees and deferred vested employees. We describe some of the failures in process below:

1. The plan application justifies the substantial benefit reductions for deferred vested participants because “terminated participants with fewer than 20 years of service tend to be younger, and are more likely to be currently employed and less dependent on benefits from the Plan” than those with 20 or more years of service. However, the determination that employees with fewer than 20 years of service are less dependent on benefits, or likely to be employed, or for that matter likely to be employed in a job with comparable pay and retirement benefits, is simply conjecture. Our own view, which is informed by our experience working with participants over four decades, is precisely the opposite: those people who left covered employment are likely to have subsequently worked in lower-wage jobs without any retirement plan. We also query whether deferred vested participants with 20 years of service are necessarily older than those with fewer years of service. This may be true, but it is a factual question and the application fails to indicate whether the assertion was tested for accuracy. And the application does not indicate why the trustees used a service surrogate for age when age itself could have been used as a criterion.

Moreover, it is not logical to believe, as the Central States trustees claim to believe, that people with fewer years of service are generally less dependent on the benefits they earned from Central States than are people with more years of service (on that portion of their benefits derived from a similar period of service.) For example, someone with 15 years of service credit under the plan may be less, as, or more dependent on that benefit than someone with 20 years of service who is dependent on the 75% of their benefit earned during their first 15 years of service. The question of dependency will turn on how much total retirement savings a participant has accumulated and their retirement needs.

We note here that we are not discussing periods of service worked for Tier I employers, since the portion of benefits based on such service would already have been reduced to the maximum extent possible.

2. Central States argues that it cut benefits more for retired participants than it did for active participants because “*all* of the plan’s participants (active, retired and terminated) and beneficiaries must rely upon the *active* participants to continue to support the Plan....” (emphasis in original). But whether retirees and terminated vested participants are better off depends on whether full benefits payable until the plan becomes insolvent, plus benefits payable thereafter through PBGC financial support to the plan, are greater than the value of the reduced benefits. And if employers withdraw from the plan (as part of a mass withdrawal or otherwise), contributions would at least be partly replaced by withdrawal liability payments.

3. Central States does not note in its application that future collective bargaining contracts may provide for new plans—either composite plans or section 401(k) plans—to make up for benefit reductions for active participants.

4. The trustees did not consider the effects of future inflation. Inflation will erode the real value of retired participants' benefits, while active employees' retirement savings—being dependent on future employer contributions to all retirement plans, including Central States—will reflect inflationary gains. The high rate of return on investments used by the actuary reflects the belief that there will be at least moderate inflation in the future.

5. MPRA requires that the sponsor of large plans appoint a retiree representative to advocate for the interests of retirees and deferred vested participants. As detailed in our earlier comments, the plan sponsor appointed an inadequate retiree representative, who failed to advocate effectively for retirees and deferred vested participants.

Please do not hesitate to contact me if you have any questions about this letter. My cell phone number is (205) 410-0989; e-mail: nps32@drexel.edu

Respectfully submitted,

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cc: The Honorable Kenneth Feinberg
The Honorable J. Mark Iwry