AMERICAN ACADEMY *of* ACTUARIES

April 17, 2014

The Honorable Harry Reid
Senate Majority Leader
United State Senate
S-221 Capitol Building
Washington, DC 20510

The Honorable John Boehner
Speaker of the House
United States House of Representatives
H-232 Capitol Building
Washington, DC 20515

The Honorable Mitch McConnell
Senate Minority Leader
United States Senate
S-230 Capitol Building
Washington, DC 20510

The Honorable Nancy Pelosi
House Minority Leader
H-204 Capitol Building
Washington, DC 20515

Re: Pension Funding Provisions of Recent Legislative Proposals

Dear Majority Leader Reid, Minority Leader McConnell, Speaker Boehner, and Minority Leader Pelosi:

The Pension Finance Task Force (PFTF) is jointly sponsored by the American Academy of Actuaries[1] and the Society of Actuaries.[2] Its purpose is to bring to the public and the United States actuarial profession expertise regarding pension finance. The PFTF believes this expertise is relevant with respect to recent proposals that would modify pension funding requirements. We hope you will consider these comments as you deliberate these proposals. The views expressed in this letter are those of the PFTF members and do not necessarily represent the views of anyone other than the PFTF.

Congress has historically recognized the importance of securely funding pension benefits. The preferential tax treatment granted qualified pension plans (deductions when contributions are

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[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.

[2] The Society of Actuaries (SOA) is an educational, research and professional organization dedicated to serving the public, its members and its candidates. The SOA's mission is to advance actuarial knowledge and to enhance the ability of actuaries to provide expert advice and relevant solutions for financial, business and societal problems. The SOA is a joint sponsor of the PFTF in its research and educational activities. The SOA does not take positions on pending legislation. Any position on pending legislation taken in this letter should not be viewed as those of the SOA.

made and no taxation of trust investment earnings) encourages sponsors to fund promised benefits before they must be paid. Minimum funding requirements were defined to provide adequate security for plan participants owed these qualified plan benefits. More recent legislation (MAP-21)[3] included modifications to the way pension liabilities are calculated for funding purposes, thereby decreasing these reported liabilities and reducing contribution requirements. MAP-21 was designed to provide short-term funding requirement relief to plan sponsors in light of economic conditions and included a schedule on which its impact would be reduced. Recent proposals, such as the Emergency Unemployment Compensation Act of 2014 (H.R. 3979 as amended by the Senate), would defer this phase-out, and by doing so, lowers the ongoing funding requirements. Extending these temporary provisions accelerates tax revenue while deferring the pension cost to future generations, distorts the pension measurements, and undermines the benefit security of plan participants while increasing the risk exposure to the PBGC.

Tax Revenue

Such proposals, as included in the Senate-amended H.R. 3979 (Sec. 9), are scored as revenue increases because they change the timing of sponsor contributions. They do not reduce the underlying benefits promised by these plans or the obligation of plan sponsors to ultimately pay those benefits. The proposal allows plan sponsors to make smaller contributions over the next few years. Since these contributions, which are currently tax-deductible, would be reduced, it is expected to result in greater tax revenue within the budget window. But sponsors that contribute less today will need to contribute more in the future, and the related deductions will merely be taken at a later date, outside of the budget window. The proposal therefore increases current revenue only by reducing future revenue.

Measurement Implications

Proponents of the proposal reason that current interest rates are artificially low because of government involvement in the fixed-income market. These lower interest rates are used to calculate the liability for pension benefits, and produce higher liability measurements. They argue that the proposal reduces the influence of anomalous interest rates through the averaging over a long period of time, and that this approach provides a more accurate measurement of pension liabilities. But these arguments do not accurately reflect the role that interest rates play in the capital markets, and the proposal would materially distort pension plan measurement.

Interest rates are always influenced by government actions. Sometimes the actions contribute to higher rates; sometimes they contribute to lower rates. This does not render resulting interest rates artificial or inappropriate. Trillions of dollars of fixed-income and derivative securities (notional value) are traded at these market interest rates daily. Market rates are also directly used in many other pension-related capacities. Pension obligations are transferred to insurance companies at prevailing market interest rates. Financial statements of pension sponsors reflect these obligations valued at market rates. H.R. 3979 as amended, moves the calculations used to determine minimum contributions away from these market rates. It extends the artificiality

[3] Moving Ahead for Progress in the 21st Century Act, [Subsequently, Public Law No: 112-141].

introduced by MAP-21 rather than allowing the intended return to more meaningful measurement principles.

We also note that government involvement in the capital markets affects the assets in pension plans, as well as the interest rates used to measure liabilities. Low interest rates directly increase the market value of fixed income assets. Equity values are also influenced by interest rates; most market observers attribute recent strong equity returns at least in part to lower interest rates. Adjusting the pension liabilities without also adjusting pension assets does not remove the effect of the current interest rate environment. Instead, it inflates measures of pension plan funded status.

Benefit Security

The amount of benefits paid to plan participants would not be changed by these legislative proposals, but the security of promised benefits may be reduced. Lower contribution requirements will very likely result in lower plan assets, providing less security for participants and increasing risk for the Pension Benefit Guaranty Corporation (PBGC). Both economic theory and market observation indicate that less secure payment promises are less valuable. In that light, proposals to lower contribution requirements, if enacted, would transfer wealth from plan participants to plan sponsors.

In addition, plans with measured funded status less than 80 percent under current law are restricted from making lump-sum distributions to participants. If pension smoothing were extended, some poorly funded plans will be considered more than 80 percent funded solely because of this "relief." The payment of lump-sum benefits by such poorly funded plans would reduce the benefit security of remaining plan participants.

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The Pension Finance Task Force appreciates your consideration of these comments. We would be happy to discuss this issue with you at your convenience. Please contact David Goldfarb, the Academy's pension policy analyst (202-785-7868, Goldfarb@actuary.org) if you have any questions or would like to discuss this issue further.

Sincerely,

Gordon J. Latter, FSA, MAAA
Chairperson, Pension Finance Task Force

CC: U.S. Members of Congress