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AMERICAN ACADEMY *of* ACTUARIES

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August 15, 2017

Larry Good  
Executive Secretary  
ERISA Advisory Council  
U.S. Department of Labor, Suite N-5623  
200 Constitution Ave NW  
Washington, DC 20210

Submitted via email to [good.larry@dol.gov](mailto:good.larry@dol.gov)

Re: Annual Funding Notice Under ERISA Section 101(f)

Dear Mr. Good:

The Pension Committee of the American Academy of Actuaries<sup>1</sup> is pleased to present comments to the ERISA Advisory Council of the Employee Benefits Security Administration regarding the Annual Funding Notice for Defined Benefit Plans (AFN), issued in accordance with the Employee Retirement Income Security Act of 1974 (ERISA) Section 101(f). We have three suggestions for improving the notice: narrow the focus, encourage helpful narrative, and provide generic information on the internet. We have included a sample of the first two pages of the notice incorporating the key suggestions in the appendix to this letter.

### **Background**

Since 2008, the Pension Protection Act of 2006 (PPA) has required all single-employer defined benefit pension plans covered by Title IV of ERISA (plan termination insurance) to provide AFNs to plan participants and any labor organizations representing them, as well as the Pension Benefit Guaranty Corporation (PBGC) if poorly funded and at the PBGC's request for better-funded plans. For plans that provide it, the AFN replaces the old Summary Annual Report (SAR).

The intent of the AFN is to provide plan participants with information regarding the plan's current funded status, and how that funded status has changed over the past three years; additionally it provides information on events expected to have a material impact on the plan's funded status during the year in which the notice is provided (the year after the plan year to which the notice relates). It

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<sup>1</sup> The American Academy of Actuaries is a 19,000-member professional association whose mission is to serve the public and the U.S. actuarial profession. For more than 50 years, the Academy has assisted 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.

also provides participants with information of the plan's termination rules, and how PBGC guarantees will protect their benefits if the plan terminates.

But the AFN as it stands is an example of a good idea gone wrong. The AFN should provide plan participants with useful, comprehensible information regarding the security of their pension benefits. The regulations even go so far as to forbid adding additional information designed to obscure the intended message. But the AFN overwhelms participants with a flood of numbers that they will have neither the context nor technical expertise to interpret—leading to the very confusion the regulations specifically seek to prevent.

### **Statutory Requirements**

To be fair, the AFN shoulders a heavy burden in trying to simply and clearly communicate complex information. The statutory disclosure requirements are lengthy, and include (for a single-employer plan):

- General information regarding the plan:
  - Identifying information about the plan, the plan sponsor, and the plan administrator
  - Information on the number of participants split into three categories
  - A statement on the plan's funding policy and the plan's asset allocation
  - A statement that the plan was subject to an informational filing under ERISA Section 4010 (if applicable)
- Generic information:
  - A summary of the ERISA rules regarding plan termination
  - Information on the benefits guaranteed by the PBGC
  - The right to receive a copy of the annual report
- Specific information regarding the plan's assets and liabilities:
  - A three-year history of the funded target attainment percentage (FTAP)
  - A three-year history of liabilities and assets (net of any funding balances) as determined to calculate the minimum required contribution
  - Liabilities and assets as of the end of the year to which the notice relates, determined using PBGC interest rates
  - Information on any material events taking effect in the current plan year and a projection of the impact of that event at year-end
- Impact of funding stabilization (if applicable):
  - An explanation of stabilized interest rates
  - A statement that stabilization may reduce contributions
  - A three-year history of the FTAP and minimum required contribution, both with and without the effects of stabilization

Multiemployer plans have slightly different but similar requirements, and must provide additional information under the Multiemployer Reform Act of 2014 (MPRA).

This is a vast amount of information to present to participants, and most of it will be of little value to the average participant without some context.

For example, a 2016 AFN, delivered in April 2017, might show seven different measures of the plan's funded status:

- Funded status at 1/1/2014, 1/1/2015, and 1/1/2016 using the stabilized interest rates in effect for each year;
- Funded status at 1/1/2014, 1/1/2015, and 1/1/2016 using the non-stabilized interest rates in effect for each year (on the temporary HATFA supplement); and
- Projected 12/31/2016 funded status using mandated PBGC interest rates.

The average pension plan participant, unfamiliar with the concept of what a pension liability represents, will likely struggle to make sense of these seven different measures. We have three suggestions to make the AFN more useful while still keeping the AFN within its statutory boundaries: narrow the focus to a single liability measure, encourage plan sponsors to provide helpful narrative, and shift generic information off the notice itself and onto the internet.

### **Narrow the Focus**

The statutory requirements cannot easily be changed, so barring additional regulatory action, the best way to improve the AFN might be to redesign it. As noted above, the notice often must provide seven different measures of the plan’s funded status, but there is nothing in the statute that requires every measure to be presented with equal emphasis. We believe it would help participants grasp the key message if the notice focused on a single measure—perhaps the market value of assets and non-stabilized liabilities as market-based measures, or the assets and liabilities used to determine the minimum required contribution—and put some context around these numbers, such as a simple explanation of the year-over-year asset and liability changes.

Disclosure of this information could be placed on the first page with appropriate explanatory text to help participants put the results in context. The remaining required disclosures would still have to be included in the notice, but could start on the second page. The DOL could determine the minimum level of disclosure to appear on this first page (for example, the pertinent measures for the current year, or the same information for the past two years, or the three years required by statute).

### **Encourage Helpful Narrative**

The statute permits the plan sponsor to provide additional information on the notice that is “necessary or helpful to understanding the mandatory information in the notice.” However, the DOL has actively discouraged certain deviations. For example, the preamble to the final regulations “strongly discourages” showing an additional funded ratio where assets are not reduced for credit balances. The strong DOL position against what many practitioners and sponsors considered to be a reasonable clarifying modification to the notice has led many to conclude that it is risky and not worth the effort to deviate from the model notice in an effort to improve its communication value. This type of DOL direction has left many sponsors unwilling to deviate from the model, even when additional information would add significant clarity.

For instance, consider a plan that offered a lump sum cashout window in 2016 that significantly reduced assets and liabilities, and lowered the plan’s FTAP because lump sums were based on Section 417(e) rates lower than the mandated stabilized segment rates at which they were valued. Even assuming this window was disclosed on the 2016 notice (provided to participants in 2017), there will be no information about it on the 2017 notice delivered in 2018. Participants will see a large unexplained change in the historical funding information—and unless they have the 2016 notice, they will have no way to determine what caused the drop. Furthermore, in many situations the window might not even have been specifically disclosed on any notice (for instance, if the window was announced, opened, and closed all during the 2016 plan year and the sponsor elected to reflect it

in the 2016 valuation); in that case even having the prior year notice will not help participants understand the change in funded status.

Another situation where additional information might be very helpful to participants is the disclosure of the FTAP, which according to the statute must be determined net of the plan's funding balances. Yet this might mislead participants into believing those assets covered by the funding balance somehow aren't "real" assets of the plan. In the first years the notice was provided, many plan sponsors wanted to show their plan's funded status without subtracting the funding balances, believing this provided a more accurate picture of the plan's situation, but again, the DOL warning in the preamble of the final regulations has discouraged this practice.

We believe plan sponsors should have the flexibility—should in fact be encouraged—to provide additional information in plain language that will help clarify the notice for non-subject matter experts. The statute explicitly permits the addition of such information; helping plan participants understand the key message of the notice should outweigh the risk that a plan sponsor might try to deliberately obscure a plan's poor funded status.

One option would be to allow the sponsor to include information beyond what is statutorily required that allows the reader to make a comparison across all of the time periods covered in the notice. For example, the table that discloses the plan's historical funded status could also include estimated values for the notice year on that year's funding basis (see attached sample notice for an example of how this might look). Then, where the required year-end funded status on the PBGC basis is disclosed, the sponsor could include an explanation of why that required measurement differs from what is shown in the first table.

Further, to the extent that events having a material effect must be disclosed, in addition to the required disclosure of the projected effect as of the end of the *current* year, the sponsors could also be permitted to disclose the estimated effect of that event on values as of the end of the *notice* year (that is, for a 2017 notice, the sponsor could disclose the projected effect as of the beginning of the 2018 plan year in addition to the statutorily required disclosure of the effect as of the end of the 2018 plan year—this could be very helpful, as many material events would already be reflected in the notice year-end values.) This way the reader would be able to make a comparison across multiple years on a consistent basis with at least some prospect of distinguishing between the factors that actually represent a change in the plan's financial condition and those that are simply a reflection of different approaches to measuring plan assets and liabilities.

### **Provide Generic Information on the Internet**

We recognize that our first two suggestions might lengthen the notice, an undesirable outcome given that the notice is already five pages long. The longer the notice, the less likely anyone will actually read it all the way through. However, we believe the notice can be significantly shortened by permitting generic information (plan termination, PBGC guarantees) to be provided through a link to a webpage, either on the plan sponsor's website, or—even better—on a website provided by the DOL specifically for this purpose. At this point, it is reasonable to assume most people have access to the internet on a computer, tablet, or phone; however, to be equitable for those without such access, the AFN could also notify participants without internet access that they can request the generic information from the plan administrator (at no charge).

Besides making the notice shorter, this approach may make it less likely that participants will misinterpret the generic plan termination information as indicating that their plan is at risk of terminating. To avoid this misconception, some sponsors routinely provide a cover letter ensuring the participants that the plan is *not* about to terminate; providing a link to a generic webpage may be less likely to be misinterpreted.

### **Additional Thoughts**

Even with all these changes, the AFN will still continue to provide a flood of information that risks overwhelming and confusing participants. If the primary purpose of the notice is to help participants understand the plan's funded status and the risk that promised benefits will (or will not) be paid, it does not do a very good job. We believe "less is more": if participants are provided appropriate streamlined information, they are far more likely to read it all and be able to better understand it—especially if plan sponsors can make available additional information to put the numbers in context.

The DOL itself cannot make statutory changes, but it may have the ability to influence such changes in the future, and we encourage the agency to do so when given the opportunity. If there is an opportunity to redesign the notice from scratch, this opens the door to significantly simplify and increase the effectiveness of the AFN communication. The Academy's Pension Committee would be pleased to serve as a resource to this effort.

We appreciate your consideration of these comments. Please contact Monica Konaté, the Academy's pension policy analyst, at 202-223-8196 or [konate@actuary.org](mailto:konate@actuary.org) if you have any questions or would like to discuss these comments further.

Respectfully submitted,

Ellen L. Kleinstuber, MAAA, FSA, FCA, FSPA, EA  
Chairperson, Pension Committee  
American Academy of Actuaries

## Appendix

### ILLUSTRATIVE ANNUAL FUNDING NOTICE<sup>2</sup> For [insert name of single-employer pension plan]

#### Introduction

You are a participant in the [insert name of single-employer pension plan]. This notice provides important information about the funding of the Plan. All traditional pension plans (called “defined benefit pension plans”) must provide this notice every year regardless of their funding status. It is provided for informational purposes and you are not required to respond in any way. This notice is required by federal law. This notice is for the plan year beginning [insert beginning date] and ending [insert ending date] (“Plan Year”).

#### How Well Funded Is Your Plan?

The law requires the administrator of the Plan to tell you how well the Plan is funded. The Plan divides its net plan assets by plan liabilities to get this percentage. In general, the higher the percentage, the better funded the plan.

The chart below shows the funded percentages for the 2016 Plan Year and each of the two preceding plan years, as well as estimated values for the 2017 Plan Year. The chart also shows you how these percentages are calculated.

	<b>Funded Percentage<sup>3</sup></b>			
	<b>2017 (estimated)</b>	<b>2016</b>	<b>2015</b>	<b>2014</b>
1. Valuation Date	1/1/2017	1/1/2016	1/1/2015	1/1/2014
2. Plan Assets	\$1,000,000	\$1,000,000	\$1,000,000	\$1,000,000
3. Plan Liabilities	1,100,000	1,100,000	1,100,000	1,100,000
4. Funded Percentage (2) / (3)	90.91%	90.91%	90.91%	90.91%

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<sup>2</sup> Note to ERISA Advisory Council: This sample is meant to illustrate only the part of the AFN that conveys the main message. There would be additional content documenting the other required elements and, potentially, including additional employer commentary.

<sup>3</sup> We suggest that only one set of results be shown on the first page. These could be provided on either a stabilized, non-stabilized, or PBGC basis. The advantage to having stabilized rates is that they are already required. Non-stabilized liabilities are not required for all plans (some plans are exempted from the MAP-21 supplement), and PBGC rates at beginning-of-year are currently not required for any plan. Thus, while there is some merit in these approaches, using stabilized or PBGC rates means sponsors would have to do more work.

### Plan Assets and Credit Balances

The chart below shows the Plan’s “credit balances,” if any, which the employer created when it contributed more than the law required in prior years. The credit balances can be used to offset required contributions in a future year. However, plans must subtract these credit balances from plan assets to calculate the required contribution and an alternative measure of the plan’s funded percentage called the Funding Target Attainment Percentage (FTAP) that is required by law to be disclosed in this notice. The derivation of the FTAP is shown in the chart below.

	<b>Funding Target Attainment Percentage</b>			
	<b>2017 (estimated)</b>	<b>2016</b>	<b>2015</b>	<b>2014</b>
1. Valuation Date	1/1/2017	1/1/2016	1/1/2015	1/1/2014
2. Plan Assets	\$1,000,000	\$1,000,000	\$1,000,000	\$1,000,000
3. Plan Liabilities	1,100,000	1,100,000	1,100,000	1,100,000
4. Funded Percentage (2) / (3)	90.91%	90.91%	90.91%	90.91%
5. Credit Balance	n/a	100,000	100,000	100,000
6. Assets net of Credit Balance (2) – (5)	n/a	900,000	900,000	900,000
7. Funding Target Attainment Percentage (6) / (3)	n/a	81.82%	81.82%	81.82%

### Plan Liabilities

Plan Liabilities in line 3 of the table above are an estimate of the amount of assets the Plan needs on the Valuation Date to pay for promised benefits under the Plan.

### Year-End Assets and Liabilities

The asset values in the charts above are measured as of the first day of the Plan Year. *[Include if the plan uses an actuarial value of assets that differs from market value. They also are “actuarial values.” Actuarial values smooth out the day-to-day fluctuations of the stock and other markets and can allow for more predictable levels of future contributions. The actuarial value of assets is never more than 10 percent higher or lower than the market value. Despite the fluctuations, market values tend to show a clearer picture of a plan’s funded status at a given point in time.]*

The liabilities shown in the tables above are determined by estimating the present value of future benefit payments using interest rates averaged over a period of time (as required by law), and typically do not reflect current market interest rates.

As of Jan. 1, 2017, the fair market value of the Plan’s assets was *[enter amount]*. On this same date, the Plan’s liabilities, determined using market rates, were estimated to be *[enter amount]*.

These values differ from the estimated values shown in the above chart as of the same date because they do not reflect [the asset and] interest rate averaging described above.

### Events Having a Material Effect on Assets or Liabilities

By law this notice must contain a written explanation of new events that have a material effect on plan liabilities or assets. This is because such events can significantly affect the funding condition of a plan.

For the plan year beginning on [*insert the first day of the current plan year (i.e., the year after the notice year)*] and ending on [*insert the last day of the current plan year*], the following events are expected to have such an effect: [*Insert explanation of any plan amendment, scheduled benefit increase or reduction, or other known event taking effect in the current plan year and having a material effect on plan liabilities or assets for the current plan year*].

[The 1/1/2017 Funded Percentage shown in row 4 of the chart above reflects these events. Without reflecting these events, the Funded Percentage would have been X%.] [The 1/1/2017 Funded Percentage shown in row 4 of the chart above does not reflect these events. If these events were reflected, the Funded Percentage would be Y%][The 1/1/2017 Funded Percentage reflects event A, but not event B. Before reflecting any of these events, the Funded Percentage would have been X%. If all events are reflected, the Funded Percentage would be Y%].

[The law also requires a disclosure of the estimated effect of these events as of the end of 2017.] The table below shows the estimated effect on the Plan's [assets and] liabilities for each event. [The law also requires a disclosure of the estimated effect of this event as of the end of 2017. The estimated effect on the Plan's [assets and] liabilities is \_\_\_\_\_.]