



AMERICAN ACADEMY *of* ACTUARIES

March 1, 2006

Mr. Gregory Jonas
Moody's Investors Service
99 Church Street
New York, NY 10007

Re: Comments on Proposed Rating Methodology for Companies participating in Multiemployer Defined Benefit Pension Plans

Dear Mr. Jonas:

The American Academy of Actuaries'¹ Multiemployer Plans Task Force appreciates the opportunity to respond to your request for comments regarding Moody's proposed rating methodology for companies participating in multiemployer defined benefit pension plans. The comments below specifically address the contents of Moody's proposed methodology.

Our concerns regarding the proposed methodology relate to the following areas:

1. Timeliness of plan information used to estimate funding status;
2. Moody's estimation of "average liability" and the applicability of an "under-funding multiple" for multiemployer plans;
3. Use of different dates for values of plan liabilities and plan assets;
4. The arbitrary assumption of the 75 percent/25 percent allocation of underfunding; and
5. The potentially significant effect of pending pension reform legislation on the determination of future liabilities of underfunded multiemployer pension plans.

1. Timeliness of Plan Information Used to Estimate Funding Status

The availability of specific plan information from public sources (such as Form 5500 filings) currently runs about two to three years behind the current date. Given the volatility in both the equity and debt markets, plan assets and liabilities can both be significantly different at a current date than they were two to three years ago. Recent changes in actuarial assumptions (such as the mandated interest rate used to determine the RPA 94 current liability) or plan benefit provisions also do not show up in historical information. Contributions to the plan in the interim also have an effect on a plan's current funded status. Changes in the assets and liabilities can materially affect any funding status calculation. The "under-funding multiple" (relating underfunding to annual employer contributions) would have to be applied to the contributions actually made in the same historical time period to be consistent.

¹ The American Academy of Actuaries is a national organization formed in 1965 to bring together, in a single entity, actuaries of all specializations within the United States. A major purpose of the Academy is to act as a public information organization for the profession. Academy committees, task forces and work groups regularly prepare testimony and provide information to Congress and senior federal policy-makers, comment on proposed federal and state regulations, and work closely with the National Association of Insurance Commissioners and state officials on issues related to insurance, pensions and other forms of risk financing. The Academy establishes qualification standards for the actuarial profession in the United States and supports two independent boards. The Actuarial Standards Board promulgates standards of practice for the profession, and the Actuarial Board for Counseling and Discipline helps to ensure high standards of professional conduct are met. The Academy also supports the Joint Committee for the Code of Professional Conduct, which develops standards of conduct for the U.S. actuarial profession.

2. Estimation of “Average Liability” and Applicability of an “Under-Funding Multiple” for Multiemployer Plans

Moody’s method of estimating “average liability” will essentially be a mix of “apples and oranges” with respect to averaging the accrued liability and RPA 94 current liability.

The RPA 94 current liability is based on the present value of benefits accrued to date, using a statutory interest rate assumption range that is tied to average long-term bond yields. A plan’s accrued liability is often based on a level percentage or dollar amount of contributions (under the entry age normal or other NON-comparable funding methods) to fund all anticipated benefits, whether earned or not yet earned, and is typically higher than the present value of accrued benefits (PVAB) calculated using the same interest rate. Further, the interest rates used by various plans for calculating accrued liability may vary. They are often affected by additional factors beyond bond rates, such as the demographics of the plan population and the plan’s investment policy, which can range from conservative to somewhat aggressive. For these reasons, the accrued liability of the plan is not an appropriate measure for determining underfunding in this context. However, it is important to note that the minimum required contribution, under both current law and pending legislation, is determined by the interest rate used in calculating the accrued liability.

It may be more consistent to use a single measure of liability based on benefits accrued to date, such as the RPA 94 current liability or the present value of accrued benefits, as found in the plan’s financial audit under FAS35 and filed with the annual Form 5500. Any adjustments could be made using actuarial “rules of thumb” for purposes of adjusting liabilities determined at one interest rate to a more appropriate interest rate, if desired, to reflect market interest rates, such as the FAS87 discount rate used for other corporate pension disclosures or other factors.

Unlike the single-employer plan environment, contributions in multiemployer plans are set by collective bargaining and, in general, if an employer pays more, it happens at the bargaining table. Normally, the only exceptions are violations of minimum funding requirements and employer withdrawal rules. The plan’s determination of ERISA withdrawal liability would be the “real world” manifestation of any sudden call on employer resources, applicable in the event of individual employer withdrawal or a mass withdrawal. The benefits valued would include only vested accrued benefits and the assumptions used in those situations could be substantially different from the measures proposed. In the former case, plans use widely varying methods, ranging from funding rates to those that reflect some element of the market for annuity purchases. In the mass withdrawal situation, statutory assumptions are used.

Absent an impending withdrawal (currently a required FAS87 disclosure), the “under-funding multiple” sheds no light on (or may in fact provide a false impression of) the period of time over which the underfunding will need to be covered. For many plans, underfunding has been a permanent part of the landscape. At one extreme is a plan “reorganization” situation where there is no hope of recovery; benefit levels will eventually be cut back to PBGC maximum levels (far lower than for single-employer plans); the PBGC will provide the cash needed to pay those benefits; and there will be only minimal additional employer commitment to make up the underfunding.

For many ongoing plans, the multiple will provide a distorted picture of underfunding’s impact on the sufficiency of current contribution rates. Primarily, this is because it does not recognize that a portion, perhaps most or perhaps none, of the employer’s current contribution represents payments to reduce the unfunded liability. Normal cost and assumed expenses, allocated over active plan participants, are often considered analogous to operating expense, while the remainder of the contributions could be considered debt (interest and principal) repayment.

Some plans may be portrayed as much better than they are by this measure, others will appear far worse than they actually are. For example, the funding level (ratio of assets to liabilities) of some plans where the funding level is

quite high, but the future is very bleak because of a declining workforce and companies leaving the industry. Rapid contribution increases may be needed to support continued benefit accruals.

On the other hand, some plans have a low funding ratio, but current contribution rates are already well in excess of the level needed to fund the ongoing long-term actuarial cost, so the ratio will be rising rapidly. A temporary decline in ratio may have occurred because the benefit level was recently improved in conjunction with a recent collective bargaining commitment to fund that increase.

A significant additional concern arises with the use of industry multiples. Plan funding varies widely by industry segment, geography, history, demographic profiles, and many other characteristics. Moody's would need to apply the individual plan-by-plan multiples for the specific plans sponsored by employer for this measure to have any degree of accuracy.

Perhaps any attempt to identify multiemployer funding risk for contributing employers should begin with disclosure and analysis of already-agreed-to contribution increases made in bargaining. However, only fundamental actuarial analysis on an individual plan basis will shed much light on the true extent of the potential risk for additional near-term contribution increases.

3. Use of Different Dates for Valuing Plan Assets and Liabilities

Members of the task force are concerned about the mismatch between the date used for valuing plan assets (as of the end of the plan year) and for valuing plan liabilities (as of the beginning of the plan year). Varying scenarios of equity market returns and interest rate changes during the plan year could result in materially different funding levels between the beginning and the end of the plan year. It is important that assets and liabilities be valued using a common date so that accurate assessments may be made. Actuaries have developed techniques to "roll forward" liabilities to a more current date.

4. The Arbitrary Assumption of the 75 Percent/25 Percent Allocation of Underfunding

Moody's states that, in the absence of more specific information, they expect companies will fund approximately 75 percent of the underfunding burden, with covered employees funding the remaining 25 percent. This is an arbitrary assumption, and may significantly overestimate or under-estimate the actual relative sacrifices by employees. There are many factors that can affect the bargaining efforts that relate to specific plan contributions, including perceived wage inequality, funding status of the pension plan, and funding status of the associated health fund. In many collective bargaining situations, employee representatives have a primary role in the allocation of dollars between basic wages and fringe benefits. If a need arises to rapidly increase funding to the pension plan, that incremental funding will often be accompanied by a freeze in wages or defined contribution benefits; also, there might be a diversion of amounts formerly allocated to another element of compensation. It is far from clear that a 75 percent/25 percent allocation is appropriate.

5. The Potentially Significant Effect of Pending Pension Reform Legislation

While Moody's does mention possible "congressional intervention" near the end of its paper, it states that it is premature to conclude when legislation will be passed or that it will contain any specific features.

Given the actual passage of the *Pension Protection Act* (H.R. 2830) and the *Pension Security and Transparency Act* (S. 1783) and the pending appointment of a House/Senate conference committee to reconcile these two bills, we would strongly encourage Moody's to hold off from implementing its methodology until after the bills have been reconciled and a final version passed and signed by the president.

Any rating methodology should reflect the impact of new laws anticipated to materially change the funding of multiemployer defined benefit pension plans. In particular, the nature of the responsibility of plan trustees and the collective bargaining parties that sponsor multiemployer plans could be significantly affected by provisions in both bills requiring accelerated funding (possibly derived from reduction in other labor costs) or benefit restrictions for under-funded multiemployer pension plans. In addition, certain elements of the proposed legislation may allow plans to reduce the amount of underfunding via changes to early retirement or other subsidies.

Another reason to defer implementation will be the increased transparency arising from any pension reform legislation enacted. Actuarial reports or certifications that would be required of a multiemployer plan by pending legislation could help address some of the information gaps for which Moody's finds itself trying to improvise solutions.

Summary

The Multiemployer Plans Task Force recommends that any methodology Moody's implements use information that is as current as possible, be consistent in the measurement of assets and liabilities, and reflect current law. We are also concerned that any such measure should not provide misleading information about the exposure of employers to underfunding risk, and suggest further research be done to fully understand the nature of a sponsoring employer's commitment to a multiemployer plan.

Members of the task force appreciate this opportunity to comment on the proposed ratings of companies that contribute to multiemployer defined benefit pension plans. We would be interested in meeting with you to answer any questions or discuss any of the concerns expressed in this letter. Please contact Heather Jerbi, the Academy's senior pension policy analyst (202.785.7869; Jerbi@actuary.org), if you have any questions or would like additional information.

Sincerely,

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Vice President, Pension Practice Council
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