



AMERICAN BENEFITS
COUNCIL

March 23, 2015

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Dear Mark, Vicki, and Robert:

On behalf of the American Benefits Council (the "Council"), I am writing with respect to the project to update the mortality tables for purposes of the pension rules, including funding, benefit restrictions, and lump sum distributions.

The Council is a public policy organization representing principally Fortune 500 companies and other organizations that assist employers of all sizes in providing benefits to employees. Collectively, the Council's members either sponsor directly or provide services to retirement and health plans that cover more than 100 million Americans.

SUMMARY

In October of 2014, the Society of Actuaries ("SOA") released new mortality assumptions recommended for valuing private sector pension liabilities. In the past, SOA's mortality assumptions have been generally noncontroversial within the actuarial

community. The 2014 assumptions have, on the other hand, been controversial. A significant number of actuaries consider the methodology used to calculate rates of mortality and the mortality projection scale to be problematic both procedurally and substantively. *In fact, some critical assumptions used by the SOA with respect to the construction of the base tables have turned out to be materially incorrect, based on data from prior years.* These problems have resulted in assumptions that can significantly overstate pension liabilities. In connection with the issuance of updated assumptions for purposes of the Internal Revenue Code, we ask that you address the problems and inaccuracies in the SOA's methodology, which are discussed in detail below.

In preparing these comments, we coordinated with our actuarial members and plan sponsors. It is our intent to continue that coordination process in order to provide concrete solutions to the problems with the SOA's tables. We will be back to you as soon as we can with those proposed solutions.

For reasons set forth below, we also ask that the new assumptions not be effective until plan years beginning after December 31, 2016 and that there be at least a 12-month period between finalization of the new assumptions and the effective date of those assumptions.

EFFECTIVE DATE

Our effective date request is set forth above. Any earlier effective date would cause three very significant problems:

- First, an earlier effective date would not leave sufficient time for a robust public policy discussion of this difficult and complex issue, including a public hearing.
- Second, an earlier effective date would almost certainly not leave a sufficient time between publication of the final rules and the effective date of the rules. The new assumptions could have an enormous effect on plan sponsors' funding obligations. Plan sponsors will generally need at least a 12-month period between publication of the final rules and the effective date in order to adjust business plans to take into account the new assumptions.
- Third, significant changes to administration/pension calculation systems and valuation calculations and programs (e.g., new relative value regulation compliance systems and possible use of a two-dimensional mortality improvement scale) will likely be needed to comply with new rules, adding to the need for a 12-month period between finalization and effective date.

KEY INACCURACY IN 2014 TABLES

Like many others, we agree that the existing mortality assumptions (based on SOA tables known as the RP-2000 Mortality Tables), which are used to value pension liabilities for purposes of the Internal Revenue Code and ERISA, are in need of updating (and must be reviewed in the near term pursuant to the Pension Protection Act of 2006). But the assumptions need to be updated in a way that accurately reflects mortality changes that have occurred and reasonable future expectations. The following highlights one key problem in the RP-2014 Mortality Tables regarding pre-2014 actual mortality improvements.

Because the data collection, analysis, and technical production of new tables takes so long, the 2014 tables are centered around 2006 data. The problem is how the SOA projects the 2006 data to 2014 to produce the 2014 base tables.

The SOA determined the rate of mortality improvement prior to 2010 based on Social Security Administration (“SSA”) data. However, in projecting the actual experience forward from 2006, little weight was given to the actual improvement data for years 2007 through 2009. The actual data on the rate of improvement for 2007 through 2009 showed a markedly lower rate of improvement than the rate assumed by the SOA for 2007 through 2009 (and was even noted in the RP-2014 Mortality Tables Report). Unfortunately, this ensured that the RP-2014 tables overstated the near-term rate of improvement after 2006.

Moreover, after publication of RP-2014, data on mortality improvements for 2010 through 2012 has become available from multiple sources (e.g., SSA, Center for Disease Control, and the Human Mortality Database), and that data similarly shows markedly lower rates of improvement than the rate assumed by the SOA for 2010 through 2012. *In short, hard data from independent expert sources demonstrate that the assumptions used by the SOA are in conflict with what actually occurred.* So we now have historical data that shows that the 2014 tables were based on projections of improvements after 2006 that *have not occurred*. Projections of future improvement from this base table will simply compound the error.

The above demonstrates an error in the RP-2014 tables, which would need to be corrected in any regulations issued by Treasury and the Service.

POST-2013 IMPROVEMENTS

The SOA’s work includes an assumption that rates of mortality will improve 1% per year indefinitely (grading down from the higher near-term rates of improvement referenced above over 20 years, and gradually starting to grade down to 0% above age 85). Opinions about rates of improvement in the future are highly speculative and a

wide range of views exists among experts. There are at least three reasons to question the SOA's assumption regarding future improvements.

First, historical rates of improvement have shown a more significant grade-down after age 85 than are reflected in the SOA's table. While this may seem like a minor point, it actually has a quite significant effect on liabilities. Mortality rates at these ages are currently high and thus change more significantly when the MP-2014 improvements are applied.

Second, in contrast, the SSA's projections at these later ages – and more generally -- are more in line with long-term historical observations (thus generating a lower level of mortality), rather than the shorter-term trends that have been more volatile. The SSA generally uses a lower average rate of long-term improvement (albeit with a longer convergence period). Although the rate of improvement varies by age, it is more equivalent to using a 0.75% long-term rate of improvement instead of the SOA's 1% rate.

Finally, the SOA's demonstrated overreliance on pre-2006 improvements casts into doubt its projection for the future as well as its relatively long transition period from those higher rates.

SPECIAL CONSIDERATIONS FOR SMALL PLANS

The post-2013 improvements proposed by the SOA study use a complex, two-dimensional improvement formula. The different circumstances of small plans justify a different regulatory approach, given the fact that many small plans pay predominantly lump sums, and small businesses and the smaller actuarial firms they employ lack the resources to pay for more complicated calculations. We urge you to consider simpler, more administrable rules, such as static tables, for small plans.

IT IS INAPPROPRIATE TO BASE LUMP SUM VALUATIONS ON A TABLE THAT WAS BUILT BY EXCLUDING LUMP SUM RECIPIENTS.

In evaluating the data on mortality, the SOA excluded data with respect to participants who received lump sums during the collection period. This poses two serious issues.

First, in the view of many actuaries, those electing lump sums are more likely to be those in poorer health. In that case, excluding this population would bias the table and overstate life expectancies by assuming that the remaining "healthier participant" mortality experience can be extended to the full pension population.

Second, in the view of many actuaries, it is inappropriate to base lump sum valuations on data that was created by systematically excluding all participants who elected lump sum distributions. An adjustment to the SOA tables would be needed to take this into account, which would result in higher rates of mortality.

We recognize the challenges that exist in assembling data on participants who elect lump sum distributions. *However, that is not a reason to adopt a set of mortality rates and improvement scales for valuing qualified plan lump sum distributions that may not be correct analytically.*

Moreover, we would highlight the fact that using incorrect mortality rates and improvement scales could create an uneven playing field, biasing employees in favor of electing lump sums and against electing annuities that provide guaranteed income for life.

Finally, we plan to make a concrete suggestion very soon with respect to how to address this important issue.

OTHER DATA EXCLUDED FROM SOA ANALYSIS

Other adjustments to the SOA tables may be needed to take into account other systematic data problems in the SOA process. For example, the data described below was excluded in the SOA process. Very notably, a far greater portion of the submitted data was rejected than was the case with respect to RP-2000, which, as noted, was correspondingly not controversial.

- Some data was excluded on the basis that it differed materially from “expected” data. The exclusion of data that does not fit expectations is a significant process problem.
- Data was excluded (at the overall plan level) for participants where a consolidated record could not be produced for the entire exposure period.
- PBGC data was never collected during the original study (that data is now with SOA).

CREDIBLE DATA FOR SUBSTITUTE MORTALITY TABLE

The material problems in the SOA’s assumptions would, unless corrected in the regulations issued by Treasury and the Service, greatly exacerbate a problem under the current regulations that warrants attention even without regard to the new tables. The problem is that the existing funding regulations (which do not apply for lump sum

valuations) depart from established actuarial credibility theory and do not permit the use of blended substitute mortality tables that are based on a combination of the regulatory tables and plan experience. The use of blended tables is entirely consistent with the statute, is widely used for accounting purposes, and, as noted, is based on very well established actuarial credibility theory.

The result under current law is a situation where, for accounting purposes, large and even mid-size plan sponsors across the country can use their own experience to create substitute mortality tables, based on a combination of standard tables and their own experience, under rigorous accounting standards. However, only a tiny portion of these organizations are able to use a substitute mortality table under Treasury regulations because such regulations depart very significantly from established actuarial credibility theory. We ask that you revisit these regulations to bring them into conformance with such established theory.

EFFECTS OF INACCURATE ASSUMPTIONS

The overstatement of life expectancy in the SOA tables, if reflected in regulations issued by Treasury and the Service, would cause defined benefit pension plan liabilities (and lump sums and other optional forms of payments) to be overvalued by tens of billions of dollars nationally, triggering several adverse effects. Many plan sponsors would be forced to overfund their plans and to cut or freeze benefits, and would put additional pressure on sponsors to de-risk more quickly to avoid inappropriate liability increases. And, of course, the overfunding required would divert scarce assets to inflated pension liabilities and away from business investment and jobs.

Also, one of the greatest concerns of plan sponsors regarding pension plan management continues to be financial volatility. As noted above, the SOA has emphasized shorter-term trends that have been more volatile rather than the longer-term historical observations. If the mortality improvement assumptions are continually adjusted to be overly sensitive to recent data, we will add mortality assumptions to the existing volatility associated with investment returns and interest rates, further challenging the health and continued existence of the private sector pension system.

These policy concerns underscore the importance of the new assumptions being accurate and technically sound.

* * *

We thank you for your consideration of the issues addressed in this letter. We look forward to discussing these issues with you further.

Sincerely,

A handwritten signature in black ink that reads "Lynn D. Dudley". The signature is written in a cursive, flowing style.

Lynn D. Dudley
Senior Vice President,
Global Retirement
and Compensation Policy

cc: George Bostick
Michael Brewer
Kyle Brown
Dominic DeMatties
William Evans
Lauson Green
Linda Marshall
Robert Neis
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Laura Warshawsky
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