AREF

American Retirees Education Foundation

NRLN

NATIONAL RETIREE LEGISLATIVE NETWORK

# Proposed Pension Annual Funding Notice Changes

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## *Executive Summary*

Companies sponsoring defined benefit pension plans are required to provide a funding notice annually to all participants and beneficiaries. In the Pension Protection Act (PPA) of 2006, Congress defined the content of this Annual Funding Notice (AFN) and required that it be furnished by the 120th day following the end of the plan year. In the Bipartisan Budget Act of 2015 (BBA), Congress added a temporary supplemental notice that shows the impact on reported funding levels due to adjusted liability discount rates – the 25-year interest rate averaging initially enacted in 2012 (the MAP-21 Act) – that plan sponsors can use to reduce the minimum required contribution for a plan year.

Unfortunately, neither the PPA nor BBA required a disclosure of a pension plan's ***actual funded status*** in a manner that is both understandable and most relevant to plan participants and beneficiaries. Attached to this paper, the NRLN proposes several common-sense changes to the Department of Labor's model Annual Funding Notice that recast the AFN from the plan participant's perspective. DOL's model AFN provides a standardized format and legal safe harbor that most plan administrators follow. We agree with the DOL's stated goal, which is "ensuring that workers receive timely and accurate notification annually of the funded status of their defined benefit pension plans." To achieve that goal, several changes are needed to make the AFN "timely and accurate" from the *participant's* perspective, and not merely from the plan sponsor's perspective.

Most fundamentally, the NRLN proposes a few changes to the headline table, on page one, that is currently captioned "Funding Target Attainment Percentage," or FTAP. The main problem is that the FTAP is a regulatory construct that plan sponsors calculate for an entirely different purpose: to determine their minimum contribution at the beginning of each plan year. However, disclosing the plan's 16-month-old FTAP does not necessarily reflect the actual percentage of liabilities the plan is able to fund at the time of the notice – which is by far the most important information sought by retirees and other participants.

There are three key shortcomings of using the FTAP from a participant perspective:

- The table discloses Plan Assets and Liabilities as of the *first day* of the plan year – valuations 16 months out of date – even though the fair market value of plan assets and the plan's liabilities on the *last day* of the plan year are disclosed lower down in the AFN.

- The table discloses Plan Liabilities calculated, most commonly, using a 25-year average of interest rates (interest rate "smoothing") legislated for a different purpose (to determine minimum funding contributions). This rate does not necessarily reflect market rates, or the rates used by the Pension Benefit Guarantee Corporation when it values plan liabilities and assesses variable rate premium payments. This non-market "adjusted rate" is also not disclosed.

- Despite using the FTAP concept (which is unfamiliar to the typical retiree or participant), the table does not disclose the Minimum Required Contribution for the plan year.

The NRLN proposes a simplified version of the FTAP table that is the same number of lines, but which is recast and recaptioned as disclosing "**Plan Funding Status**." This revised table discloses the "Percentage of Plan Liabilities Funded" (line 4) as a straightforward division of Total Plan Assets (line 2) and Total Plan Liabilities (line 3) as of the last day of the plan year and using market rates – both of which the DOL model AFN requires to be in the AFN, in what is now the "Year-End Assets and Liabilities" section, which our amended model deletes to avoid redundancy.

From a participant's perspective, a more timely and accurate (market-based) disclosure of Plan Funding Status is both most appropriate and imposes no significant added burden on plan sponsors. Currently plans are valued as of the 1st day of the plan year, but AFNs are not received until 120 days after the end of that plan year, 16 months later. AFNs should disclose plan valuations effective on the final day of the plan year (typically December 31), which is more accurate and feasible considering that the fair market value of the plan's assets and liabilities on the last day of the plan year are reported in the AFN (in narrative, although only for the current plan year).

The NRLN proposes three additional changes to DOL's model AFN: First, the section of the AFN that explains the impact of a distress termination and PBGC benefit guarantees should include a short table showing the "**Percentage of PBGC Termination Liability Funded**" as of the last day of the plan year (and using the same assumptions as the Plan Funding Status table noted above). As the AFN should explain, the PBGC calculates termination liability using a discount rate derived from a periodic survey of insurance industry rates and published on the PBGC website. It is an indication of the downside risks of a "distress" plan termination. This same PBGC termination liability is currently estimated and reported to the PBGC by plans falling below the 80 percent funding threshold, along with other data.

Second, the NRLN proposes that the AFN's current disclosure of "**Participant Information**" be displayed in tabular form and – like other AFN disclosures – show the Plan Year and the two previous plan years. Since the other funding disclosures allow a comparison over three years, providing comparable data with respect to changes in the number of covered participants by type (active, retired, separated but vested) can assist retirees and others understand or ask more informed questions about year-to-year changes in funding status.

Finally, the NRLN proposes adding one line to the Assets Allocation table showing the **Average Return on Assets for the Plan Year**. This can provide useful context, particularly where the AFN shows a large swing in a plan's Percentage of Plan Liabilities Funded.

In sum, **retirees deserve a more relevant and timely disclosure of the Percentage of Plan Liabilities Funded**, both on a fair market value basis (using the non-adjusted PPA discount rate) and also based on the PBGC measure of Termination Liability. Congress can again improve the utility and relevance of the AFN for the average participant by authorizing the DOL to make the common sense changes proposed above.

The whitepaper researched and written for the American Retirees Education Foundation (AREF) is the source of information for this Executive Summary. The AREF expands the research and education reach of the NRLN.

***For a copy of the whitepaper on this subject, contact Alyson Parker at 813-545-6792 or executivedirector@nrln.org***