DEPARTMENT OF THE TREASURY
WASHINGTON, D.C. 20220

November 3, 2016

Board of Trustees, Ironworkers Local 16 Pension Fund
8600 LaSalle Road, Oxford Building, Suite 624
Towson, MD 21286

Dear Mr. Martorana, Mr. McKeogh, Mr. Vaynblat, and the Board of Trustees:

On March 26, 2016, you submitted an application to the Secretary of the Treasury (Secretary or Treasury) on behalf of the Board of Trustees of the Ironworkers Local 16 Pension Fund (Fund, Plan). The application you submitted (Application) requests approval to reduce benefits under the Multiemployer Pension Reform Act of 2014 (Kline-Miller or Act).

As Special Master, appointed by the Secretary, I am writing to notify you of Treasury's decision to deny the Application because the proposed suspension fails to satisfy the statutory criteria for approval.

In my role as Special Master, I have reviewed the Application under the terms of Kline-Miller, its implementing regulations, and other applicable law. I also have reviewed the comments received on the Application from organizations and individuals.

Under the Act, Treasury, in consultation with the Pension Benefit Guaranty Corporation (PBGC) and the Secretary of Labor (DOL), must approve an application upon finding that the plan is eligible for the benefit suspensions and has satisfied the applicable statutory requirements.[1] The Act requires, among other things, that the Application demonstrate that the proposed benefit suspensions are reasonably estimated to allow the plan to avoid insolvency.[2] Treasury cannot approve an application under Kline-Miller unless the proposed benefit suspensions would reasonably ensure the plan's long-term solvency. As described further below, Treasury does not find that the Plan's proposed benefit suspensions are reasonably estimated to allow the Plan to avoid insolvency.

Specifically, after reviewing the Application and consulting with PBGC and DOL, Treasury has determined that the suspensions described in the Application fails to satisfy the requirement set forth in Kline-Miller "that the proposed benefit suspensions, in the aggregate, be reasonably estimated to achieve, but not materially exceed, the level that is necessary to avoid insolvency",

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[1] Code§ 432(e)(9)(G)(i); 29 U.S.C. § 1085(e)(9)(G)(i).

[2] "Limitations on Suspension-Any suspension of benefits made by a sponsor pursuant to this paragraph shall be subject to the following limitations: ... Any suspension of benefits in the aggregate ... shall be reasonably estimated to achieve ... the level that is necessary to avoid insolvency . . . ." Code§ 432(e)(9)(D)(iv); 29 U.S.C. § 1085(e)(9)(D)(iv). In the interest of simplicity, all citations below to Kline-Miller will refer only to the Internal Revenue Code even though Treasury's findings and conclusions have been made under both the Internal Revenue Code and the Employee Retirement Income Security Act of 1974, as amended.

because the mortality and the hours of service assumptions used for this purpose are not reasonable. Code§ 432(e)(9)(D)(iv).

Treasury's key findings are described below.

FINDINGS

Kline-Miller requires the Secretary of the Treasury to approve, in consultation with PBGC and DOL, an application for suspension of benefits "upon finding that the plan is eligible for the suspensions and has satisfied the criteria of subparagraphs (C), (D), (E), and (F)" of section 432(e)(9) of the Internal Revenue Code (Code), as amended by Kline-Miller.[3] The Application fails to satisfy the criteria of subparagraph (D)—which requires that benefits be reasonably estimated to avoid insolvency— as further described below.

Requirement that Suspension Be Reasonably Estimated to Avoid Insolvency

Section 432(e)(9)(D) of the Code provides that:

> [a]ny suspensions of benefits under a plan, in the aggregate . . . , shall be reasonably estimated to achieve, but not materially exceed, the level that is necessary to avoid insolvency.

Pursuant to the regulations implementing this provision, an applicant must use actuarial projections to demonstrate that a suspension satisfies this requirement. One type of required actuarial projection is a deterministic projection of cash flows, under which the plan's asset balance is projected forward using assumptions regarding the amounts of money coming into the plan (for example, contributions, withdrawal liability payments, and investment returns) and the amounts going out of the plan (for example, benefit payments and administrative expenses). The period over which the applicant generally must demonstrate that it satisfies this requirement is at least 30 years.

The regulations require that each of the actuarial assumptions and methods, as well as the combination of actuarial assumptions and methods, used for the required actuarial projections be reasonable, taking into account the experience of the plan and reasonable expectations.[4] In evaluating whether the assumptions and methods used in the application are reasonable, Treasury has referred to guidance provided by the Actuarial Standards of Practice (ASOPs), which are the principal professional standards that apply to the actuarial profession.

The ASOPs require that historical and current demographic data relevant as of the measurement date be taken into account in selecting actuarial assumptions and methods, and the ASOPs further require that the assumptions have no significant bias. The actuary also must consider the materiality of the assumptions and the balance between the benefits of using refined assumptions (that is, assumptions that are based upon more extensive and specific study and research) and the cost of using those refinements. In addition, the ASOPs and regulations require that each of the

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[3] Code § 432(e)(9)(G)(i).

[4] 26 C.F.R. § 1.432(e)(9)-1(d)(5)(iv)(B).

assumptions or methods be appropriate for the purposes of the measurement (which means, among other things, that factors specific to the measurement must be taken into account). In this case, the measurements are the cash flow projections that are required under Kline-Miller.

Treasury has concluded that two of the assumptions used for the actuarial projections in the Application – the mortality and mortality improvement assumptions and the assumptions about hours of service – are not reasonable.

The Mortality and Mortality Improvement Assumptions Are Not Reasonable

The mortality and mortality improvement assumptions used in the Application are not reasonable because they:

- do not take into account relevant historical and current demographic data;
- have a significant bias in that they overestimate the rate at which Plan participants and beneficiaries will die; and
- are not appropriate for the purpose of the intended measurement (that is, cash flow projections to demonstrate solvency under Kline-Miller).

The Mortality Assumptions Do Not Take Into Account Relevant Historical and Current Demographic Data

The Application uses a mortality table, the 1983 Group Annuity Mortality Table (1983 GAM Table), that is significantly out of date. The 1983 GAM Table was based on mortality experience from the 1960s that was projected to 1983 based on U.S. population data since 1966. Mortality rates have declined significantly since the early 1980s; the Annual Report of the Social Security Trustees, for example, notes an approximately 28 percent decline in mortality rates between 1985 and 2015.[5] By relying on an outdated mortality table, the Application underestimates the future benefit payments that must be taken into account in projecting cash flows.

Of even greater significance, the Application made no provision for mortality improvement for the period from 1983 to the proposed effective date of the suspension, or for the 30-year solvency projection period following the effective date of the suspension. In failing to account for mortality improvement, the Plan disregarded the mortality improvement scales issued by the Society of Actuaries (SOA) to be used with the 1983 GAM Tables, as well as improvement scales issued by the SOA for their 2000 and 2014 mortality tables based on anticipated mortality improvements in the United States.[6] The Plan provided no information or analysis to support its

[5] *See* Bd. of Trustees, Fed. Old-Age & Survivors Ins. & Disability Ins. Trust Funds, The 2016 Annual Report of the Board of Trustees of the Federal Old-Age and Survivors Insurance and Disability Insurance Trust Funds, H.R. Doc. No. 114-145, at 87 tbl.V.A1, *available at* https://www.ssa.gov/OACT/TR/2016/tr2016.pdf (showing the death rate per 100,000 decreased from 1,081 in 1985 to 781.4 in 2015).

[6] The SOA is the only professional organization in the United States engaged in actuarial research and education that issues mortality tables and mortality improvement scales for private pension plans. Treasury has historically relied on the mortality tables and mortality improvement scales issued by the SOA for pension plan funding and other purposes.

position that there has been no mortality improvement for plan participants since 1983 and that there will be no mortality improvement during the 30-year solvency projection period. The Plan's failure to justify its position is contrary to the requirements of the ASOPs.

The Plan has asserted that the 1983 GAM Table is consistent with the higher mortality rates experienced by the Plan. In support of this assertion, the Plan provided Treasury with data on 166 deaths over an eight-year period, with the number of deaths in a year ranging from a low of 14 to a high of 29. However, this limited experience data is not statistically credible for purposes of supporting the selection of a non-standard mortality assumption for a plan. For full statistical credibility, the Plan would need to have experienced a substantially greater number of deaths. Under a generally accepted approach for determining mortality assumptions for pension plans, more than 1,000 deaths would be required to give the plan's experience full statistical credibility. Although partial credibility (which would allow a plan to use a blend of a standard mortality table and a mortality table reflecting its own experience) can be established with fewer than 1,000 deaths, the Plan did not attempt to use partial credibility to justify its mortality assumptions.

For the cash flow projections required under Kline-Miller, demonstrating partial credibility would generally require a plan to submit an analysis of pension-weighted mortality experience for retirees over an applicable experience period; the Plan failed to perform the applicable analysis.

The Mortality Assumptions Have a Significant Bias

The mortality and mortality improvement assumptions used in the Application have a significant bias. Specifically, the Application significantly underestimates the future benefit payments that must be taken into account in projecting cash flow because using the 1983 GAM Table results in an overestimate of the rate at which Plan participants and beneficiaries will die. This bias has a material effect on the cash flow projections. A recalculation of the effect of the proposed suspension on the Plan's projected solvency using modern tables with a modern mortality improvement scale (the RP-2014 Mortality Tables for Blue Collar Employees, Healthy Annuitants, and Disabled Retirees projected with Scale MP-2015) illustrates this bias, showing that the Plan is projected to become insolvent by 2043, with a negative asset balance of $20 million by 2047. This would cause the Application to fail the requirement of Code section 432(e)(9)(D) that the suspension of benefits be at a level that is reasonably estimated to avoid insolvency.

In response to concerns expressed by Treasury regarding the Plan's use of the 1983 GAM Table, the Plan asserted that it would continue to avoid insolvency if it used an SOA 2000 mortality table (the RP-2000 blue collar table) with no projected mortality improvement. However, use of the RP-2000 blue collar table with no projected mortality improvement is also an unreasonable assumption. The Plan again failed to provide sufficient information or analysis to support its position that there has been, and will be, no mortality improvement during the relevant periods.

To the contrary, the Annual Report of the Social Security Trustees notes an approximately 19 percent decline in mortality rates between 2000 and 2015.[7]

The Mortality Assumptions Are Not Appropriate for the Purpose of the Measurement

While the Plan uses the 1983 GAM Table for purposes of the minimum funding requirements[8] (a determination of the minimum amount that must be contributed annually to the Plan) and for purposes of determining actuarial equivalence among benefit options under the Plan, these are very different measurements than the cash flow projections required under Kline-Miller. The Kline-Miller cash flow projections require determination of, and are sensitive to, point-in-time cash inflows and outflows for the purpose of determining solvency, and under the statute are one-time calculations. In contrast, compliance with the minimum funding requirements is an annual determination that is adjusted from year to year (and variances from the actuarial assumptions are reflected in the plan's experienced gains and losses), and determining actuarial equivalence between benefit options is a present value calculation that is not sensitive to timing of cash inflows and outflows from the plan.

In evaluating whether actuarial assumptions are appropriate for the purpose of a measurement, the ASOPs provide that factors specific to the measurement must be taken into account. By its nature, a cash flow projection is highly sensitive to differences in certain actuarial assumptions, and is generally much more sensitive than point-in-time present value calculations, such as a plan's determination of the minimum amount that must be contributed annually to the plan. Because a mistaken judgment of an element of cash flow can result in a projection of plan solvency when a more refined projection would show insolvency, it is critical that factors specific to cash flow projections be taken into account.

In the case of a benefit suspension under Kline-Miller, the following factors are relevant and should be taken into account in selecting actuarial assumptions:

- that a participant's or beneficiary's loss of benefits (once reduced pursuant to a suspension) is permanent—amounts reduced will not be returned;
- that the amount of the suspension cannot easily be (and will not automatically be) increased or decreased in a later year if the plan's actual experience proves to be different than projected; and
- the timing of future expected benefit payments and their impact on cash flow at any given point during the extended period for projecting insolvency.

In other words, an applicant selecting actuarial assumptions for purposes of the cash flow projections under Kline-Miller must take into account that the assumptions will be used for a solvency determination by a pension plan in the context of a potential benefit suspension

[7] *See* footnote 3 (the table in the report also shows the death rate per 100,000 decreased from 960.7 in 2000 to 781.4 in 2015).

[8] Even for the purpose of determining minimum funding, the Plan is an outlier among plans in using the 1983 GAM Table. Of the 29 Ironworkers plans with more than 1,000 participants that filed federal information returns for the 2014 plan year, the Plan was the only one that used the 1983 GAM Table, and the 1983 GAM Table was the most outdated table used by any of these plans.

involving permanent reductions to the benefits of participants that will not be returned or automatically self-corrected if future experience differs from expected. Because using more refined mortality assumptions in connection with a cash flow projection would produce materially different results in these circumstances (as explained above), and would not be unduly costly for the Plan,[9] the Plan should have chosen a mortality table and improvement scale that reflects and gives appropriate weight to relevant and historical demographic data.

Based on the foregoing, Treasury has determined that the mortality assumptions are not reasonable, and therefore the proposed suspension does not satisfy the statutory requirement that it be reasonably estimated to avoid insolvency.

The Hours of Service Assumption Is Not Reasonable

To project cash flows, an applicant must determine the amounts that participating employers are expected to contribute to the plan. In the case of a multiemployer plan, these contributions are generally a direct function of the number of contribution base units (or CBUs). In this Plan, the CBUs are the hours of service performed by members of the Iron Workers Local Union No. 16, which is based in Baltimore, Maryland, for participating employers. Currently, employers that have entered into a collective bargaining agreement with the Iron Workers Local Union No. 16 are required to contribute $9.70 to the Plan for each CBU.

The Application assumes that after many years of decreasing CBUs, including a significant acceleration in the rate of such decreases in the last three years, CBUs will be 275,000 for 2016 and will remain unchanged at that level through 2046. Neither the Application nor supplementary information the Plan provided establishes a sufficient basis for this assumption.

The CBU assumption is not reasonable because it:

- does not take into account relevant historical and current demographic data; and
- has a significant bias in that it is significantly optimistic with respect to the employer contributions during the solvency projection period.

The Assumption Does Not Take Into Account Relevant Historical and Current Demographic Data

The Plan's assumption that CBUs level off in 2016 and remain constant for the next 30 years does not take into account relevant historical and current demographic data. The assumption disregards the decrease in CBUs experienced by the Plan over the past 10 years and the acceleration of this decline in recent years – a 10 percent decrease in 2014, a 16 percent decrease in 2015, and a 19 percent decrease estimated by the Plan trustees for 2016 – averaging 15 percent per year for the past three years. Even if the average rate of decrease were lowered to eliminate the one-time, recent large decline attributable to the loss of an employer in 2015, the average rate of decrease in the past three years would be 12 percent.

[9] The valuation software used by virtually all multiemployer plans can easily accommodate the use of a modern mortality table and improvement scale at minimal expense.

Further, the recent decrease in CBUs has coincided with a period of general economic expansion. Between February 2010, when the unemployment rate in Baltimore peaked following the most recent recession, and March 2016, when the Application was submitted, the unemployment rate in Baltimore dropped from 8.7 percent to 5.3 percent, indicating a favorable economic cycle between those dates. The continued decrease in CBUs during much of this period, however, indicates that the decline in CBUs is not the result of general economic conditions, but rather, at least in part, systemic changes affecting union employment in the Baltimore ironwork industry.

Although the Plan has pointed to two upcoming projects that may provide additional work opportunities for union members, it has provided no reliable evidence in the form of signed labor agreements or otherwise that the declining trend in CBUs will change. In fact, the Plan observed in its Application that there is less work in the industry in the Baltimore region, that employers are competing for a dwindling share of that work, and that, in order to increase market share and thus CBUs, the union and its signatory employers must capture areas of the market in which they do not currently work and that are dominated by non-union contractors that pay lower wages and benefits. Significantly, the Plan states in its Application with respect to CBUs that "[t]he hours continued to fall through 2015 and are projected to further decline in 2016 and beyond." This statement ("and beyond") contradicts the assumption that CBUs level off in 2016 and remain constant thereafter.

The Assumption Has Significant Bias

The assumption that the Plan's CBUs will level off at 275,000 hours in 2016 and will remain unchanged at that level for the next 30 years results in a material overstatement of the amounts that will be contributed to the Plan by participating employers, and therefore demonstrates significant optimistic bias. For example, if the CBUs were to decline by 12 percent in 2017 and 2018 before stabilizing at 213,000 hours, the Plan would become insolvent in 2044. Similarly, if the rate of decrease in CBUs were 8 percent for the next three years after which CBUs would be assumed to remain level at 214,000, the Plan would be projected to become insolvent in 2045.

Based on the foregoing, Treasury has determined that the hours of service assumption is not reasonable and that the proposed suspension does not satisfy the statutory requirement that it be reasonably estimated to avoid insolvency.

CONCLUSION

The Application fails to meet the requirements of Kline-Miller for the reasons described above. This notification letter will be made public in order to inform plan participants and beneficiaries of the outcome of Treasury's review.

Respectfully,

Kenneth R. Feinberg
Special Master