DEPARTMENT OF THE TREASURY
WASHINGTON, D.C.

August 11, 2020

John Sullivan
Robert Holden
Board of Trustees
Local 807 Labor-Management Pension Fund
32-43 49th Street
Long Island City, NY 11103

Re: Local 807 Labor-Management Pension Fund Application for Benefit Suspension

Dear Mr. Sullivan, Mr. Holden and the Board of Trustees:

On December 30, 2019, you submitted an application to the Secretary of the Treasury (Secretary or Treasury) on behalf of the Board of Trustees of the Local 807 Labor-Management Pension Fund (Fund). The application you submitted (Application) requests approval to reduce benefits under the Multiemployer Pension Reform Act of 2014 (MPRA).

Treasury has reviewed the Application under the terms of MPRA and MPRA's implementing regulations. Treasury also has reviewed the comments received on the Application from organizations and individuals.

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.

Under MPRA, 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] After reviewing the Application and consulting with PBGC and DOL, Treasury has determined that the suspension described in the Application fails to satisfy the requirement set forth in MPRA "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."[2] Specifically, Treasury has determined that the investment return assumption is not reasonable under the standards in the regulations. Treasury's key findings are described below.

FINDINGS

MPRA requires the Secretary of the Treasury to approve an application for a suspension of benefits, in consultation with PBGC and DOL, "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 MPRA.[3]

[1] Code§ 432(e)(9)(G)(i).
[2] Code§ 432(e)(9)(D)(iv).
[3] Code § 432(e)(9)(G)(i).

As further described below, the Application fails to satisfy the criteria of subparagraph (D) of Code § 432(e)(9) because it does not comply with the limitation of clause (iv) of subparagraph (D), which requires that "[a]ny suspensions of benefits, in the aggregate . . . shall be reasonably estimated to achieve, but not materially exceed, the level that is necessary to avoid insolvency."[4] This letter does not address whether the Application satisfies any of the other criteria of Code § 432(e)(9).

Requirement that Suspension Be Reasonably Estimated to Avoid Insolvency

The regulations implementing Code § 432(e)(9) require that an applicant use actuarial projections to demonstrate that a suspension, in the aggregate, is reasonably estimated to achieve, but not materially exceed, the level that is necessary to avoid insolvency.[5] One of the projections required is a deterministic projection[6] of cash flow throughout an extended period under which the plan's available resources are projected forward using assumptions regarding the cash flows into the plan (e.g., contributions, withdrawal liability payments, and investment returns) and out of the plan (e.g., benefit payments and administrative expenses). The extended period over which an applicant must demonstrate that it satisfies the requirement to avoid insolvency is at least 30 years, starting with the first day of the plan year that includes the effective date of the suspension.[7]

Standards for Selecting Actuarial Assumptions Used in Projections

Treasury evaluated the assumptions and methods used in the Application based on the regulations. The regulations require that each of the actuarial assumptions and methods used for the required projections, as well as the combination of actuarial assumptions and methods, are reasonable, taking into account the experience of the plan and reasonable expectations.[8] In applying the regulations, Treasury referred to guidance provided by the professional standards that apply to the actuarial profession, which include the Actuarial Standards of Practice (ASOPs), as referenced in the regulations.[9]

The regulations require that, to be reasonable, each of the assumptions or methods must be appropriate for the purpose of the measurement, meaning, in this instance, that factors specific to a benefit suspension must be taken into account. The ASOPs also require that reasonable assumptions take into account historic and current demographic and economic data that are relevant as of the measurement date and that the assumptions have no significant optimistic or pessimistic bias. Further, the ASOPs provide that the plan's actuary must consider the materiality of the assumptions and the balance between the benefits of using more refined actuarial assumptions (that is, assumptions that are based upon more extensive and specific study and research) and the cost of using those refinements.

---

[4] Code § 432(e)(9)(D)(iv).
[5] 26 C.F.R. § 1.432(e)(9)-1(d)(5).
[6] A deterministic actuarial projection is a projection based on inputs that are assumed to occur. These projections are in contrast to stochastic actuarial projections, which estimate the probability of a range of outcomes as a result of random variation in one or more inputs (e.g., the investment return) over time.
[7] 26 C.F.R. § 1.432(e)(9)-1(d)(5)(ii)(C).
[8] 26 C.F.R. § 1.432(e)(9)-1(d)(5)(iv)(B).
[9] TD 9765, 81 FR 25540, 25549. In this case, the relevant ASOPs are numbers 4, 27, 35, and 41.

Selection of Actuarial Assumptions for this Application

Treasury has concluded that a key actuarial assumption—the Fund's investment return assumption—is not reasonable under the standards in the regulations. Because the cash flow projections in the Application rely on an unreasonable assumption, the Application fails to demonstrate that the proposed suspension is reasonably estimated to achieve, but not materially exceed, the level that is necessary to avoid insolvency. Accordingly, the proposed suspension does not meet the statutory requirements for approval because it does not satisfy the limitations set forth in Code § 432(e)(9)(D).[10]

The Investment Return Assumption Is Not Reasonable

The Application uses an assumption that incrementally increases throughout the entire extended period. As shown in the chart below, the investment return for the initial year of the extended period is assumed to be 5.5%. By the end of the extended period it is assumed to increase to 8.1%.

Plan Year Beginning 9/1	Investment Return	Plan Year Beginning 9/1	Investment Return
2020	5.5%	2042	7.3%
2021	5.5%	2043	7.3%
2022	5.6%	2044	7.4%
2023	5.7%	2045	7.4%
2024	5.8%	2046	7.5%
2025	5.9%	2047	7.5%
2026	5.9%	2048	7.6%
2027	6.0%	2049	7.6%
2028	6.1%	2050	7.7%
2029	6.2%	2051	7.7%
2030	6.3%	2052	7.8%
2031	6.4%	2053	7.8%
2032	6.5%	2054	7.8%
2033	6.6%	2055	7.9%
2034	6.7%	2056	7.9%
2035	6.8%	2057	7.9%
2036	6.9%	2058	8.0%
2037	6.9%	2059	8.0%
2038	7.0%	2060	8.0%
2039	7.1%	2061	8.1%
2040	7.1%	2062	8.1%
2041	7.2%		

[10] MPRA Applications must be subject to public notice and comment pursuant to section Code § 432(e)(9)(G)(ii). If the Fund were to revise the cash flow projections in the Application (i.e., so that they are based on different, actuarial assumptions and methods), the Treasury Department could not rely upon those revised projections in evaluation of the current Application because the revised projections would not have been subject to public notice and comment. *See Air Transport Ass'n of America v. FAA*, 169 F.3d 1 (D.C. Cir. 1999).

The Fund's target asset allocation is as shown below:

Asset Class	Allocation
US Equity – Large Cap	21%
US Equity – Small/Mid Cap	12%
Non-US Equity – Developed	12%
US Corporate Bonds – Core	14%
US Treasuries (Cash Equivalents)	21%
Real Estate	10%
Infrastructure	10%
Total	**100%**

Treasury has concluded that this assumption is not reasonable because it does not adequately take into account relevant current economic data (that is, appropriate investment forecast data); and it has a disqualifying bias in that it is significantly optimistic.

The Investment Return Assumptions Do Not Take into Account Relevant Current Economic Data

Treasury evaluates the investment return assumptions used in suspension applications by consulting current investment return data, specifically the 2019 Survey of Capital Market Assumptions, developed by Horizon Actuarial Services (Horizon Survey), which is widely used in evaluating the capital market assumptions utilized by multiemployer defined benefit plans.

The Horizon Survey shows the geometric expected average annualized investment return at the 25th and 75th percentile of results for each asset class on both a short-term basis (a 10-year investment horizon) and a long-term basis (a 20-year investment horizon). Treasury's assessment of a plan's investment return assumption corresponds to this structure: the short-term expected return for the first 10-year period of a plan's extended period is analyzed separately from the long-term investment return for the remainder of the extended period. Specifically, Treasury uses the short-term results of the Horizon Survey to assess the reasonableness of the investment return assumption a plan uses for the first 10 years of its extended period and the long-term results of the Horizon Survey to assess the reasonableness of the assumption for the remainder of the plan's extended period. Treasury uses stochastic simulation to assume that the returns for individual asset classes follow a normal distribution. The return for any year is assumed to be independent of the return for any other year, and the portfolio is rebalanced at the end of each year to match a plan's target asset allocation.

In the case of the Fund, applying the median expected geometric average annualized return for years 11 and after in the Horizon Survey to a portfolio comprised of investments in asset classes similar to those of the Fund's target portfolio would yield 6.52%, with the 25th percentile return being 5.97% and the 75th percentile being 7.01%.

Based on this analysis of the Horizon Survey's results for the long-term for the Fund's target portfolio, the Fund's 7.01% investment return assumption is at the 75th percentile under the Horizon Survey for that period.[11] Treasury is of the opinion that an investment return assumption must be demonstrably closer to the median than to either the 25th percentile or the 75th percentile results for both the first 10 years of the extended period and the longer term to be considered reasonable. Thus, Treasury concludes that the investment return assumption is unreasonable because it is overly optimistic for the longer term as compared to the relevant current economic data in the Horizon Survey.

Moreover, Treasury examined the data and analysis used to support the Fund's selection of a long-term investment return assumption that steadily increases throughout the entire extended period. Of specific concern is that the return assumption includes material increases in expected returns after 30 years. Expected returns are often assumed to exhibit an increasing pattern over time, similar to a yield curve. However, there are so few bonds with a maturity of over 30 years that it is impossible to benchmark assumed increases in expected returns beyond that time horizon using the yield curve comparison. The Fund cites the use of a proprietary model that considers (among other metrics) the entire Treasury yield curve and the "natural" very long-term interest rate level for the one-month Treasury rate. These factors are said to have been developed from "a mosaic of information that included historic information, current Federal Reserve policy, economic theory and information and expectations about the future gleaned from professional judgement."[12] However, this rationale is insufficient to justify increases in expected returns of about 50 basis points between 2049 (30 years from the beginning of the projection) and the plan year beginning 2062 (the end of the extended period). Accordingly, Treasury has concluded that the Fund's Application fails to provide sufficient data and analysis to support its long-term assumption that would override the analysis based on the comparison of the Fund's assumption to the results of the Horizon Survey.

The Investment Return Assumption Has Significant Bias

In addition, the investment return assumption used in the Application does not satisfy the requirement that assumptions have no optimistic bias. The assumption is significantly optimistic, as evidenced by the available relevant investment return forecast data in the Horizon Survey described above, and the assumption has a material effect on the actuarial projections in the Application.

Given that the investment return assumption for the longer term of the extended period is overly optimistic, it is not reasonable to arrive at a determination that the proposed suspension is reasonably estimated to avoid insolvency, as required by Code § 432(e)(9).

CONCLUSION

For the reasons set forth above, Treasury has concluded that the Application fails to demonstrate that the proposed suspension satisfies the requirement that it be reasonably estimated to achieve, but not materially exceed, the level that is necessary for the Fund to avoid insolvency. As a

[11]The average rates of return for the portfolio in this paragraph are geometric averages (used as the basis for the assumption for the deterministic projections).
[12] Application pg. 105.

result, the Application fails to demonstrate that the proposed suspension satisfies the limitations set forth in Code § 432(e)(9)(D), which is required for approval of a proposed suspension. Accordingly, the Application is denied.

This notification letter will be made public in order to inform plan participants and beneficiaries of the outcome of Treasury's review.

Respectfully,

Danielle Norris

Danielle Norris

MPRA Director