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Subject: Response to Request for Comment on Proposed Rule "Lump Sum Payment Assumptions" Published September 30, 2019 (RIN 1212–AB41)

Mercer is pleased to respond to PBGC's request for comments on its proposed regulation on Lump Sum Payment Assumptions. Mercer is a global consulting leader delivering advice to help organizations meet the health, wealth and career needs of their workforce. Mercer provides consulting and actuarial services to approximately 1,000 US pension plans and employs enrolled actuaries who assist plan sponsors, some of which would be affected by this proposed regulation.

In general, we believe that the proposed changes to the lump sum interest rates are helpful and appreciate PBGC's efforts to modernize its methodology. However, we are concerned about the effect these changes will have on private sector pension plans still using the pre-1994 PBGC lump sum basis to calculate lump sums (no less than the statutory minimum under IRC Section 417(e)), or to convert an account balance into an annuity.

Alternative Rates for Appendix C

The preamble states the change to 417(e) assumptions would have a minimal effect on participants and beneficiaries because the interest and mortality assumptions would offset each other. As an example, the preamble cites a close match for a deferred-to-age-65 annuity for someone age 40 — within 1%. However, the fit is not as good at other ages, particularly where the annuity starting age is lower than 65. We agree with PBGC that continuing to publish rates using an outdated methodology no longer makes sense, especially in today's low interest rate environment. We also support publishing a surrogate rate to provide an ongoing actuarial basis for plans that refer to the Appendix C rates. However, we do not feel that replacing the PBGC immediate interest rate with a fixed interest rate (e.g., 1.50% as in the proposed regulations) makes sense, as that could lead to excessive subsidies if/when interest rates rise to historically more normal levels.

As an alternative, we recommend that PBGC select an appropriate floating interest rate as a surrogate in lieu of the proposed fixed 1.50% immediate interest rate. (Please note that although the current four-tier structure could easily be maintained, we are not opposed to fixing the deferred interest rates at 4%, as those rates have all been at 4% since 2001). What might be an appropriate rate depends on PBGCs objectives for the replacement rate. If the goal is to find an easy-to-maintain proxy for 417(e) assumptions, simply adopting the 417(e) assumptions would achieve this objective. If instead the objective is to maintain some level of equivalency with the historical approach, other proxies are readily available. For example, the monthly average 10-year or 30-year Treasury yields (for the second month prior) are highly correlated with PBGC's immediate rate (with the 30-year Treasury yield tracking the PBGC rate more closely). Either of these rates might be adopted (with or without a fixed basis point adjustment, depending on PBGC's objectives) without requiring any ongoing effort on the part of PBGC. We purposely chose a single interest rate rather than a yield curve for this purpose, to avoid the need for material changes to pension administration systems.

Effective date

If the final rule provides for a substitute rate higher than the current immediate rate — leading to lower lump sums — we recommend the effective date be deferred for a short period or phased in. For example, PBGC's continuing to publish the historical rates for six months would give most plans and participants sufficient lead time (a year or more for plans using an annual stability period) to understand the impact of the change and make informed decisions.

Applicability of Appendix B or Appendix C Interest Rates

PBGC has also requested information regarding whether pension plans were amended to refer to Appendix C in light of the 2000 regulatory change. To the best of our knowledge, most plans were not amended. We understand that PBGC's position, based on PBGC's 2000 regulations, is that a plan lacking language specifically referencing the legacy rates could be construed as using the Appendix B interest rates, rather than the Appendix C rates. Assuming that this is the correct interpretation, then once PBGC's proposed changes are adopted, references to PBGC's lump sum rates for these plans would require the use of the same IRC Section 417(e) methodology that plans must already use for minimum lump sum purposes. Such a change would effectively eliminate the calculation based on PBGC rates and should not be significantly disruptive to implement. However, it may not always be clear whether such plans should, in fact, apply the Appendix B or Appendix C rates once those rates diverge. The correct interpretation may depend on the plan's precise wording, as well as on the IRS's interpretation of which set of rates should apply in this situation.

For plans that are deemed to follow the Appendix C rates, any future changes will raise anticutback issues. Absent any IRS relief, those plans will be forced to maintain the Appendix C rates for benefits accrued through the date of the switch. For frozen plans, the legacy basis will need to be maintained indefinitely. It is therefore possible that despite few plans having explicitly adopted the Appendix C rates, more plans will be affected by the proposed change. As noted above, we believe that using a fixed rate could lead to excessive subsidies when interest rates rise again. Accordingly, we encourage PBGC to consider a basis that continues to adapt to changes in the interest rate environment.

We appreciate the opportunity to provide our comments on the proposed regulation, and would be happy to discuss this information at a mutually convenient time.

Sincerely,

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