Exh. CN-1T
Docket TP-220513
Witness: Christopher Noble

BEFORE THE STATE OF WASHINGTON

UTILITIES AND TRANSPORTATION COMMISSION

WASHINGTON UTILITIES AND TRANSPORTATION COMMISSION, Complainant, v. PUGET SOUND PILOTS, Respondent.	Docket No. TP-220513

TESTIMONY OF

Christopher Noble

ON BEHALF OF

PACIFIC MERCHANT SHIPPING ASSOCIATION

Actuarial Review of PSP Pension Proposal

FEBRUARY 10, 2023

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I. INTRODUCTION

Q: Please state your name and business address.

A: Christopher F. Noble, Noble Actuarial Consulting LLC, Port Angeles, WA.

Q: Please describe your actuarial experience.

A: I have been engaged in actuarial services for large and mid-sized private defined benefit pension plans since 1997.

Q: What is your area of expertise as an actuary?

A: Funding, accounting, compliance, and administration of private defined-benefit pension plans in the U.S.

Q: Would you please summarize your educational and professional background both as an actuary and prior to becoming an actuary?

A: I have a Ph.D. in mathematics from Cornell University. I am a Member of the American Academy of Actuaries and a Fellow of the Society of Actuaries. I held the Enrolled Actuary credential from 2001 to 2021. My resume is Exhibit CN-2.

Q: Please describe your experience for the Actuarial Standards Board.

A: I was a member of the Pension Committee of the ASB from 2012 through 2019 and chaired that committee for the last three years of service. I have been a member of the Actuarial Standards Board since January 2022.

Q: What is the purpose of the Actuarial Standards Board?

A: The Actuarial Standards Board (ASB) sets standards for appropriate actuarial practice in the United States through the development and promulgation of Actuarial Standards of Practice (ASOPs). These ASOPs describe the procedures an actuary should follow when performing actuarial services and identify what the actuary should disclose when communicating the results of those services.

Q: Please describe your work in the actuarial field to promote actuarial standards of practice and include an identification of any formal Actuarial Standards currently in practice that you personally participated in drafting.

A: The Pension Committee of the ASB is the drafting committee for standards related to pension practice. The ASB reviews and edits drafts from the drafting committees and has final authority on the language in all ASOPs. In addition to my work on the Pension Committee and the ASB, I have been a frequent speaker on ASOPs at professional meetings of pension actuaries. My work on the ASOPs that may be relevant to creation of a defined-benefit plan for Puget Sound Pilots and review of related testimony includes:

- ASOP No. 4, *Measuring Pension Obligations and Determining Pension Plan Costs or Contributions*: I served as a member of the drafting committee for the version currently effective and chair of the drafting committee for the first two exposure drafts of the version to become effective beginning February 15, 2023.
- ASOP No. 27, *Selection of Economic Assumptions for Measuring Pension Obligations*: I chaired the drafting committee for the two exposure drafts

leading to the current version as well as for much of the work in the final version.

- ASOP No. 35, *Selection of Demographic and Other Noneconomic Assumptions for Measuring Pension Obligations*: I chaired the drafting committee for the two exposure drafts leading to the current version as well as for much of the work in the final version.
- ASOP No. 51, *Assessment and Disclosure of Risk Associated with Measuring Pension Obligations and Determining Pension Plan Contributions*: I chaired the drafting committee for the final version and was a member of the drafting committee for all exposure drafts.

I have served on the drafting committee or as a member of the ASB for other standards as well.

Note that any representations that I make about the content of ASOPs are attributable only to me and should not be construed as representing the views of the ASB.

II. PURPOSE AND SUMMARY OF TESTIMONY

Q: What is the purpose of your testimony?

A: My testimony is limited to actuarial review of the cost and compliance issues of the tax-qualified defined-benefit pension plan proposed in the Puget Sound Pilots rate filing and actuarial review of associated testimony provided by Christopher Wood and Bruce McNeil.

Q: Can you please summarize your testimony?

A: Significant obstacles to the maintenance of a tax-qualified multiple-employer defined benefit pension plan for the Puget Sound Pilots are not adequately addressed in the testimony of Mr. Wood and Mr. McNeil. Those obstacles include application of legislative restrictions that would prevent the plan from providing the same benefits as the current pilots' plan and onerous administrative expenses that are not reflected in the projections provided by Mr. Wood. I have also included a description of an alternative retirement program arrangement that could be considered in this or future rate cases.

III. REVIEW OF PSP'S ACTUARIAL 50-YEAR COST PROJECTIONS

Q: Were you able to review the testimony of Christopher Wood, the actuary consulting with the Puget Sound Pilots, at Exhibit CRW-01T?

A: I was able to review the information in Exhibit CRW-01T, including review of the projections in Exhibit CRW-05 for reasonableness, subject to the limitations on that exhibit and the limitations of the data in Exhibit CRW-03-06-29-22.

Q: What is your general impression of the 50-year contribution projections offered by Mr. Wood in his testimony?

A: The projections include caveats indicating that compensation and benefit limits under ERISA have been ignored and administrative costs have not been reflected. Subject to those caveats, I find that the pattern and approximate magnitude of the projected costs are reasonably consistent with the data in Exhibit CRW-03 and the assumptions described in Exhibit CRW-04. I also find that the assumptions employed in the projections, other than the assumptions implied by the caveats, are reasonable for the purpose of the projection. However, the caveats are material to decisions about the formation of the plan. In addition, there are significant risks that key assumptions will not be realized and that required contributions for the funded defined benefit ("DB") plan will exceed the projected contributions.

Q: How do the Actuarial Standards of Practice apply to the projections in Mr. Wood's testimony?

A: The projections reflect measurements of pension obligations and determination of pension plan contributions. As such, ASOP No. 4 provides guidance on appropriate methods and information that should be disclosed. ASOP Nos. 27 and 35 provide guidance on the selection of the assumptions used in the projections. If the projections were intended to be used to determine plan contributions, then ASOP No. 51 would also apply and would require an assessment and disclosure of significant risks that projected contributions may be insufficient. ASOP No. 44, *Selection and Use of Asset Valuation Methods for Pension Valuations*, is applicable, but the relevant guidance in that ASOP is that the use of fair value of assets in the projection is reasonable. Several ASOPs that apply more broadly than to pension valuations also apply. Those include ASOP No. 1, *Introductory Actuarial Standard of Practice*, ASOP No. 17, *Expert Testimony by Actuaries*, ASOP No. 23, *Data Quality*, ASOP No. 41, *Actuarial Communications*, and ASOP No. 56, *Modeling*.

Q: How did you apply these Actuarial Standards of Practice when reviewing Mr. Wood's 50-year cost projections?

A: I find that the actuarial methods employed in the projections were consistent with the guidance in ASOP No. 4. ASOP Nos. 27 and 35 allow that a range of assumptions may be found to be reasonable. I find that each assumption described in Exhibit CRW-04 is within a range that may be found to be reasonable. However, ASOP Nos. 27 and 35 also require that the actuary disclose the information and analysis used to support the actuary's determination that the assumption is reasonable. I am aware of no such disclosure accompanying Mr. Wood's testimony.

Q: What are some of the assumptions that Mr. Wood made that led you to the conclusion that projections are reasonable for the purpose of the projection, subject to the caveats on the projection?

A: The discount rates and mortality assumption are reasonably close to the discount rates and mortality assumptions that would be employed in calculating required contributions for a new pension plan under current law. The retirement age assumption is reasonably consistent with the apparent retirement ages of current retirees. Other assumptions are reasonably consistent with assumptions in common use for similar purposes and are not likely to have a significant impact on the pattern and approximate magnitude of the projected amounts.

Q: What are the risks associated with the discount rate assumptions made by Mr. Wood?

A: Regulatory discount rates in 2023 are slightly lower than the rates used by Milliman[1] as of July 1, 2021. Because the discount rates required to be used for qualified plan minimum required contributions are constrained by long-term average market rates, the required rates are likely to decline further in coming years, especially after 2030 when the legislated floor on rates begins to relax. Lower discount rates would increase the required contributions to the plan. If market rates continue to increase as they have in recent months, the effect of the declining long-term average may be muted, but in the short term, defined benefit plan contributions are likely to be higher than those shown in Milliman's projections due to lower discount rates.

Q: What are the risks associated with the expected return assumptions made by Mr. Wood?

A: Milliman's structure for the investment return assumption is difficult to analyze in detail, with the rate of return varying over time; but it is equivalent to a long-term rate of approximately 6%. The assumed rates of return may not be unreasonable for a diversified portfolio; but achieving those returns will likely require some allocation to more volatile asset classes, such as stocks, creating significant variation in actual returns. Such variations will create significant deviations (up or down) in required contributions from the projection.

[1] Mr. Wood's firm at the time of his testimony. Exh. CRW-01T:1.

Q: What are the risks associated with the mortality assumptions made by Mr. Wood?

A: The IRS annually updates the required mortality assumption used to determine minimum required contributions. Historically, those updates have tended to increase plan obligations and required contributions. However, the mortality experience used to set the assumption does not yet reflect the effects of the COVID-19 pandemic on life expectancy, so the historical norm might not continue unchecked when experience from 2020 and 2021 is included in the development of the prescribed mortality assumption. Milliman's projections have assumed no change in the prescribed mortality assumption, slightly understating required contributions in the short-term and potentially understating long-term contributions for the DB plan if the overall trend in the required assumption is similar to the historical pattern.

Furthermore, the Society of Actuaries study of mortality experience, upon which the prescribed tables are based, indicates that on average, highly compensated individuals live longer than the general population. Data used in the actuarial work indicates that the pilots would fall into the highly compensated group, which suggests that in the long-term the plan may experience losses due to payments lasting longer than expected, increasing required contributions to the plan.

Q: What are the risks associated with the participant gender assumptions made by Mr. Wood?

A: Milliman has assumed that all pilots are male. Because females have longer life expectancy than males, if any pilots are female, the Farebox costs would be slightly higher in the later years. In the DB plan, those higher future expected payments are recognized immediately and would increase required contributions starting in 2022.

Q: What are the risks associated with the plan expenses assumptions made by Mr. Wood?

A: No plan expenses have been included in the projection. Required contributions in the DB plan would be increased by expected expenses to be paid by the plan, potentially including Pension Benefit Guarantee Corporation ("PBGC") premiums, administrative costs, actuarial and accounting fees, and investment expenses. The proposed multiple-employer plan is administratively and actuarially complex, with separate actuarial calculations to determine required contributions required for each participating pilot, including retired pilots in the plan. Consequently, expenses for the proposed plan are likely to be disproportionate to its size. Omission of such expenses creates a material understatement of the cost of the proposed defined benefit plan and misrepresents the savings achieved by the accelerated funding in the proposed plan.

Q: Does Mr. Wood's testimony disclose an assessment of significant risks that the projected plan contributions may be insufficient?

A: No.

Q: In layman's terms, can you please describe what these risks mean to Mr. Wood's cost projections and why these risks may be significant?

A: Actuarial projections show a single point in a wide range of feasible outcomes. Adverse experience may significantly change the long-term costs of the plan from those projected. Without an assessment of the risks to plan funding, entities responsible for making required contributions could end up being surprised by contributions significantly exceeding those in the projection.

Q: Is it methodologically important to actuaries to evaluate and include considerations for these types of risks when estimating 50-year cost projections?

A: If the projections are to be relied upon to determine funding for the proposed plan, then ASOP No. 51 requires that they be accompanied by an assessment of the significant risks to the plan's future funded status and contributions that result from experience (such as investment returns, participant retirement ages, and participant longevity) differing from the assumptions used. Even if the projections are not to be relied upon to determine plan funding, making a commitment to fund the plan without an assessment of the range of feasible funding scenarios would be like using a variable rate mortgage to buy a home without considering the possible effects of interest rate increases.

Q: Are there provisions in the Actuarial Standards of Practice to test these risks with sensitivity tests and stress tests?

A: Yes. ASOP No. 51 provides some guidance about ways to assess funding risks, including sensitivity tests and stress tests.

Q: Did Mr. Wood's testimony demonstrate any application of sensitivity tests or stress tests?

A: No.

Q: Aside from the risks you identified in Mr. Wood's cost projections, you found the other assumptions to be reasonable for this purpose?

A: Yes.

Q: Does that mean that you are convinced that these are the only assumptions that would be reasonable for this analysis and this is the only reasonable actuarial projection?

A: No. ASOP Nos. 27 and 35, which provide guidance on selecting assumptions for measuring pension obligations, indicate that a range of assumptions may be reasonable for this purpose. Changing any assumptions would change the projection.

Q: So, in layman's terms, sensitivity tests would help illustrate the range of alternative 50-year contribution projections that are reasonable estimates?

A: Yes

Q: Please explain what some potential alternative assumptions in a sensitivity adjustment might include.

A: A lower discount rate would better reflect actual rates that are required to be used and would provide a less optimistic view of the cost of the plan. A lower expected return on invested assets would significantly reduce the apparent savings from pre-funding benefits. A more conservative mortality assumption may better reflect the expected trajectory of regulatory mortality assumptions or capture the anticipated effect of the longevity of highly compensated individuals. Variations in the number of active pilots in the future would also have a potentially significant impact on the projected contributions.

Q: Have you prepared alternative 50-year cost projections based on what some of these potential alternative assumptions would look like for changes in the discount rate and changes in the number of pilots?

A: Yes. At the request of Pacific Merchant Shipping Association, I provided estimated 50-year projections for the following changes in assumptions:

(1) Reduce discount rate and expected return on assets by 100 basis points. Under current law, the discount rates will never fall below 3.75%. Therefore, while this scenario is not a worst case, it is reasonably conservative relative to the range of likely discount rates. For simplicity, the reduced discount rates are assumed to apply in all years, even though it would take several years before the actual required rates could possibly get that low.

(2) Retain Milliman's assumed discount rate and reduce active pilot count to 44 pilots. Milliman indicates that their projections reflect a steady count of 52 active pilots. My adjustment allows the count to drop to 44 through normal attrition before new pilots are brought into the plan to keep the count at that level.

Q: Have you provided charts that show how these projected adjustments would impact projected contributions?

A: Yes. They are included in the attached report, which is Exhibit CN-3.

Q: Are there any disclaimers that you would like to make with respect to these projections?

A: Yes, in order to provide comparability, these additional projections are based on estimates of the sensitivity of Milliman's projections to the discount rate and active pilot count. They rely on the Milliman projection and were not developed independently from Milliman's projections. Our sensitivities are intended only to provide an estimate of the impact on Milliman's projections of changes in key assumptions. In light of Milliman's caveats on the use of their projections, and on the issues with the underlying assumptions discussed above, these additional projections should not be used for any purpose other than understanding the impact of changes in these key assumptions.

Q: Acknowledging these caveats, what do these alternative cost projections show?

A: Decreasing the discount rate and rate of return on invested assets does not change the projected cost of the current Farebox plan, but significantly increases the cost of the proposed plan. Decreasing the projected number of participating pilots reduces the cost of both the Farebox plan and the proposed plan.

Q: In a description to a layman, how did changing these variables result in these different outcomes than in Mr. Wood's cost-projection?

A: Reducing the discount rate and rate of investment return has no impact on the benefits to be paid by the current Farebox plan. However, reducing the discount rate increases the measure of the pension obligation, which increases required contributions. Reducing the expected return on plan assets reduces the income generated by investments that is used to pay benefits, so larger contributions are required to make those benefit payments.

Reducing the projected number of active pilots reduces the amount of retirement benefits to be paid in both the current plan and proposed plan, reducing costs in both.

Q: Does that make Mr. Wood's actuarial projections wrong or less accurate?

A: The fact that different assumptions produce different projections is expected, and different estimates may both be reasonable. I would not conclude that Mr. Wood's projections are wrong or less accurate than alternatives using different reasonable assumptions.

Q: Again, can you please describe in layman's terms why it is important to test alternative and multiple scenarios when considering estimated 50-year cost projections?

A: Reality is not going to match any particular projection. Multiple scenarios can help to illustrate the range of likely outcomes.

Q: Did Mr. Wood's testimony provide any evidence of his consideration of a range of reasonable assumptions in his 50-year cost study?

A: I found no such evidence in his testimony, but in separate communications Mr. Wood conveyed to me that "for purposes of providing estimated plan funding requirements upon which budgeting expectations could be developed, especially in the context of the changed economic environment that has emerged recently as well as changes to plan funding requirements being discussed in Congress, we would expect to develop more detailed assumptions, collect full demographic data, and run projections using a range of assumptions in order to communicate to stakeholders expected costs as well as the sensitivity of costs to economic and demographic factors."

Q: Are there other portions of Mr. Wood's cost projections that stand out to you as significant?

A: The projections show that total contributions are reduced when benefits are moved into a qualified defined benefit plan. This reduction is entirely attributable to use of the earnings on invested assets to help pay the benefits.

Q: Why is this significant or important to consider?

A: The proposed defined benefit plan is not required to achieve the apparent cost savings. The same savings can be achieved by investing the contributions shown in any tax-advantaged vehicles, for example in participant IRA's or other defined contribution plans. Because defined contribution plans do not pool participants' mortality experience, if benefits were provided through defined contribution plans, then long-lived participants would need to rely on additional sources of savings to achieve the same lifetime income while short-lived participants would leave a larger inheritance to their heirs. But the benefits provided by the defined contribution plan would average the same as the benefits provided by the defined benefit plan if assets were invested in the same way and expenses were the same between the plans.

Q: Are the proposed future defined benefits plans analyzed by Mr. Wood to be administered subject to the federal Employee Retirement Income Security Act of 1974, otherwise known as ERISA?

A: That is my understanding.

Q: Can you explain what rules are applicable when analyzing the limitations imposed by ERISA on defined benefit plans?

A: Defined benefit pension plans under ERISA are subject to limitations under IRC 401(a)(17) on the participant compensation that can be taken into account in determining benefit amounts. That limit is $330,000 for compensation in 2023. In contrast, the assumed compensation of pilots used to determine benefits in the projection is approximately $400,000 in 2023. IRC 415(b) imposes limitations on the benefits that can be paid from ERISA pension plans. Further analysis would be required to determine when those limits might apply to pilots in the proposed plan. Finally, IRC 436(c) imposes restrictions on benefit accruals in underfunded plans. Such restrictions would likely apply to some participants if plan benefits reflect pilots' years of service prior to the formation of the plan.

Q: Do Mr. Wood's projections include any assumptions for compensation and benefit limitations under ERISA?

A: The notes on CRW-04 indicate that the limitations under 401(a)(17) and 415(b) have been ignored. My understanding is that restrictions under 436(c) have also not been reflected in the projections.

Q: In layman's terms, what changes to the 50-year cost projections would you expect from reflecting these statutory restrictions?

A: The effect of each of these statutory restrictions would be to reduce the benefits that could be provided in the tax-qualified plan. That reduction would reduce the required contributions to the plan, reducing the prefunding of benefits and the total investment return. In summary, the effect would be to reduce the apparent savings in the plan. I expect that the magnitude of the effect would be significant.

Q: In this regard, do you agree with Mr. Wood's disclaimer that his projections were prepared only to estimate the relative impact on plan funding requirements of the three scenarios outlined by PSP in its petition here?

A: I believe that Mr. Wood's cautions against the use of his cost-projections for any purpose other than to estimate their relative impact on plan funding requirements under the three scenarios outlined by PSP is a prudent disclaimer. However, omitting administrative costs and ignoring legislative limitations distort the comparison of the current Farebox plan to the other scenarios.

Q: Did Mr. Wood's testimony provide any evidence that he was directed to use these assumptions and only these assumptions by his client PSP?

A: The exhibits CRW-03 and CRW-04 attached to Mr. Wood's testimony provide no indication that the assumptions were selected by his client. Under ASOP Nos. 27, 35, and 41, the absence of such disclaimer means that Mr. Wood takes responsibility for the selection of the assumptions. ASOP No. 17 makes clear that disclosure of the use of assumptions not selected by the actuary applies to Mr. Wood's testimony.

Q: What are the Actuarial Standards for maintaining accuracy and disclosure when an actuary is being directed to use assumptions by a client versus selecting assumptions the actuary believes are reasonable?

A: Under ASOP Nos. 27 and 35, if assumptions are prescribed by another party (such as a client), the actuary is required to disclose that fact and to either (1) indicate that the assumption significantly conflicts with what the actuary believes to be reasonable for the purpose, (2) indicate that the actuary was unable to determine if the assumption is reasonable, or (3) provide rationale for the actuary's determination that the assumption does not significantly conflict with what the actuary believes to be reasonable. In addition, if it were material to his testimony, ASOP No. 17 would require Mr. Wood to disclose whether the projections were consistent with projections resulting from assumptions that he would have selected.

Q: Does Mr. Wood's cautions against the use of these cost-projections for any purpose other than to estimate the relative impact on plan funding requirements amongst these three scenarios suffice for this purpose?

A: ASOP No. 4 requires an actuary to disclose the purpose of the measurement and to disclose that the measurement may not be applicable for other purposes. I believe that this caution is appropriate in these circumstances. However, under this ASOP, the cautions should have been provided to all intended users of the measurement, so I would have expected that statement to be included in his testimony or attached to the exhibits.

IV. ISSUES REGARDING THE MULTIPLE-EMPLOYER DEFINED BENEFIT PLAN PROPOSED BY PSP

Q: In addition to the testimony of Christopher Wood at Exhibit CRW-01T, were you able to review the testimony of Bruce McNeil, pension attorney retained by PSP, at Exhibit BJM-01T?

A: Yes. I was able to review Mr. McNeil's testimony from the perspective of a pension actuary. My review should not be construed as legal advice, which I am not qualified to provide.

Q: Did Mr. McNeil include in his testimony a legal review of the requirements of a defined benefit pension plan qualified under sections 401(a)(17) or 415(b) of the Internal Revenue Code?

A: No.

Q: Why is the provision of such a legal review of these sections of the Internal Revenue Code advisable in your experience?

A: There are several qualification issues for the proposed plan that have not been addressed in testimony. Participant compensation that may be used in the determination of benefits in a qualified defined benefit pension plan is limited by IRC 401(a)(17). That limit is adjusted annually for inflation and is $330,000 in 2023. It is unclear how the benefit formula in the current Farebox plan could be used in a tax-qualified plan without applying this compensation limit and reducing benefits. Benefits provided by a tax-qualified defined benefit plan are limited by IRC 415(b) and accruals of those benefits may be restricted by IRC 436(c). In addition, IRC 413(c) imposes additional requirements on the funding of multiple-employer defined benefit plans with which it may be onerous to comply. In particular, such plans require that a minimum required contribution be calculated separately for each participating employer (each pilot), creating additional actuarial and auditing expenses and likely requiring contributions from retired pilots.

Q: Could the reduction in benefits due to sections 401(a)(17), 415(b), and 436(c) be made up by PSP internally after applying this compensation limit?

A: Yes. PSP could also maintain a non-qualified, unfunded excess plan to pay benefits that cannot be paid in the qualified plan, but that would require additional calculations and increase administrative complexity and cost.

Q: Are those calculations addressed in PSP's proposed defined benefit plan?

A: No. The testimony does not address the need for a nonqualified, unfunded excess plan.

Q: Are the increased aspects of administrative complexity addressed in PSP's proposed defined benefit plan?

A: No. The testimony does not address the administrative burden of either the proposed qualified plan or of the excess plan that would be required to provide the full amount of the benefits in the current Farebox plan.

Q: What are the types of risks that often face a defined benefit plan like the one proposed by PSP?

A: The most prevalent risk to these plans is difficulty meeting funding requirements.

Q: What are the funding risks associated with the creation of a defined benefit plan?

A: Qualified defined benefit pension plans are required to pre-fund benefits. Consequently, conversion of any part of the current Farebox plan to a qualified DB plan will accelerate the need for contributions. Minimum contribution amounts are determined under IRC 430 and reflect the value of benefits accruing, amortization of unfunded past accruals, and amortization of changes in the plan's funded status (positive or negative) other than by required contributions. Decreasing discount rates and adverse plan experience (such as worse-than-expected investment performance, earlier-than expected retirements or larger-than-expected increases in the retirement base) may create unanticipated spikes in required contributions. Such unanticipated increases in required contributions can be difficult to manage for some plan sponsors.

Q: Are these funding risks associated with the creation of the PSP plan adequately addressed by Mr. McNeil's testimony in your experience?

A: No. Calculation of required contributions and analysis of the factors that affect those calculations are actuarial in nature. I would not expect someone who is not an actuary to address those risks.

Q: In your experience are there other areas of practical considerations and issues in the establishment of defined benefit plans that you believe are unaddressed in Mr. McNeil's testimony?

A: Yes. Mr. McNeil's assertions that PSP would "perform the actuarial analysis for one plan in a single report" and "satisfy the funding requirements under sections 412 and 430 of the Code for one plan" are factually correct because it would be one plan, but the testimony does not reflect the rules in IRC section 413(c) for multiple-employer defined benefit plans. That code section, together with the instructions for the annual Form 5500 for the plan, require that minimum required contributions be calculated and made separately for each participating employer. In this plan, those contributions would vary widely between pilots. In the scenario in which past service is included in plan benefits, some participants would have required contributions approaching their full compensation for the year. In addition, some pilots who retired with benefits in the plan would likely have required contributions after retirement. Failure of any pilot to make the required contributions would have the same implications for the plan that Mr. McNeil describes for separate defined benefit pension plans for each pilot, but some of the potential consequences of failure to make required contributions could apply to the entire plan.

Mr. McNeil's testimony also does not address the considerable administrative complications of a tax-qualified defined benefit plan and associated costs, the burden of investment management, the complications associated with poor funded status of the plan, or nondiscrimination issues.

Q: What are the issues outstanding regarding potential administrative complications?

A: Qualified defined benefit plans are required to offer participants some alternative forms of payment (e.g., a form in which the surviving spouse receives a percentage of the initial benefit amount other than the 50% provided in the current plan). Procedures would need to be established to determine the amount of such alternative forms of payment, provide participants an election opportunity and appropriate information and disclosures, and implement payment of the elected form. Furthermore, qualified defined benefit plans are required to accept Qualified Domestic Relations Orders (QDROs) that meet appropriate criteria. A QDRO would assign a portion of the participant's benefit to another party. The plan would need to have procedures in place to review and implement such orders. Tax-qualified pension plans generally use actuaries and ERISA legal counsel to establish appropriate administrative procedures and forms.

Q: What are the issues outstanding regarding potential investment considerations?

A: A qualified DB plan must have processes in place for prudent management of invested funds. Failure to maintain prudent processes could result in unnecessary funding issues and potential penalties imposed by the IRS.

Q: What are the issues outstanding regarding potential funded status considerations?

A: When plan asset values fall below certain critical threshold percentages of the funding target (present value of accrued benefits), restrictions on the operation of the plan are imposed under IRC section 436. If service prior to plan formulation is included in the qualified DB plan, the likelihood of encountering those restrictions will be high until those past accrued benefits have been funded. Although these restrictions do not apply for a new plan's first five years, when past service is included in the plan, the restrictions are likely to apply to some of the participants starting in year six unless contributions in excess of the minimum required contributions are made to accelerate the funding for long-service participants.

Q: Does any of the testimony submitted by either Mr. McNeil or Mr. Wood examine the question of whether the proposed multiple employer plan by PSP would encounter nondiscrimination issues?

A: No.

Q: What are the issues outstanding regarding potential nondiscrimination issues?

A: If any of the sponsors of the multiple employer plan has employees other than the covered pilot, the plan may be required to include some or all of those additional employees under IRC sections 401(a)(4), 401(a)(26) or 410(b).

Q: What are the issues outstanding regarding potential additional administrative expenses?

A: Qualified pension plans must pay annual premiums to the PBGC. Premiums in the first year could range from approximately $5,000 if the plan provides benefits only for future service to approximately $80,000 if benefits for past service are included in the plan. In addition, services of an Enrolled Actuary would be required annually for the PBGC premium filing and the Form 5500 filed with the IRS, and services of an accountant would be required to audit the financial statements of the plan when the number of participants in the plan, including retired participants, exceeds 100 and any other time that the plan sponsor elected such an audit out of prudence.

Mr. McNeil estimated the cost of establishing the plan would be approximately $55,000. I believe that the annual cost of maintaining the plan would be far greater.

Q: Does any of the testimony submitted by either Mr. McNeil or Mr. Wood propose a plan where individual pilots would make any level of contributions to underwrite their own future retirement benefits under the proposed plan?

A: No.

Q: Does any of the testimony submitted by either Mr. McNeil or Mr. Wood demonstrate that they examined or considered the question of whether individual pilots would make contributions to underwrite their own future retirement benefits under the proposed plan?

A: No.

Q: In addition to your review of the testimony of actuary Mr. Wood at Exhibit CRW-01T and pension attorney Mr. McNeil at Exhibit BJM-01T, did you work with PMSA on the development of questions and requests for additional information that were ultimately presented to PSP as formal data requests in this case?

A: I assisted with the development of questions. It is my understanding that the questions were presented to PSP. I am not aware of whether they were ultimately presented to Mr. Wood and Mr. McNeil by PSP, but I would have expected PSP to rely on its experts to respond to those questions.

Q: After the preparation of these questions submitted as formal data requests to PSP, were you able to review any substantive responses from Mr. Wood or Mr. McNeil in the preparation of your testimony in this case?

A: No, I was not able to review responses to the formal data requests. Previously, in June 2022, Mr. Wood provided helpful clarifications concerning the data and actuarial methods and assumptions used in his 50-year projections in response to my questions to him. But after the preparation and submission of the more recent questions submitted as formal data requests in this case, I have not been able to review any substantive responses.

Q: Why were you unable to review any substantive responses to the formal data requests regarding PSP's proposed retirement plan transition and the actuarial review underlying it?

A: PSP did not provide substantive answers to any of the formal data requests that were submitted regarding its proposed retirement plan and its actuarial study or the testimony of Mr. Wood and Mr. McNeil. I've attached a copy of "PSP Responses to PMSA's DRs 471-545 PILOT RETIREMENT" to this testimony as Exh. CN-4.

Q: Does the lack of substantive responses by Mr. Wood and Mr. McNeil to the questions that you helped to develop and that were posed in PMSA's Data Requests 471-545 impact your ability to fully analyze, review, and provide advice regarding the proposed retirement plan?

A: Yes. Some of the questions that I helped develop were intended to build a common understanding of how the proposed plan would operate and how much it would cost. In the absence of constructive answers to those questions, it seems that the proposed plan would be an inefficient and possibly ineffective tool for providing pilots with the retirement income they would expect from the current Farebox plan because the cost of administering the plan would be disproportionate to its size and restrictions on benefits would prevent the plan from providing the same benefits as the current Farebox plan.

V. CONSIDERATION OF ALTERNATIVES TO THE RETIREMENT PLAN PROPOSED BY PSP

Q: Are there viable options and alternatives available to PSP that could be considered at a future rate case aside from a Multiple Employer Defined Benefit Plan such as the one proposed by PSP?

A: Yes.

Q: Please describe some alternative program arrangements that might be considered as a substitute for the existing PSP retirement plan in addition to the PSP-proposed Multiple Employer Defined Benefit Plan.

A: The current plan is an unfunded defined benefit plan. As such, it can operate without the cost of compliance with the legal requirements of a tax-qualified plan. However, because benefits are not funded when earned, the plan imposes costs for current services on future rate payers, and it depends entirely on those payments from future rate payers for the security of retirement benefits earned in the plan.

For several decades, corporate sponsors of defined benefit plans have been transitioning away from those plans to defined contribution retirement plans. Nearly all new defined benefit plans during that period have been small plans intended primarily to provide tax-deferral for highly compensated professionals, such as dentists and lawyers. Few new plans have been created for the primary purpose of providing secure retirement income. Defined benefit retirement plans have fallen out of favor with corporate sponsors largely because of the volatility and unpredictability of the cost and required contributions for those plans. In contrast, defined contribution plans relieve the entity responsible for funding the plan from significant uncertainties about the magnitude of future contributions.

Typically, when corporate sponsors transition from a defined benefit retirement plan to a defined contribution retirement plan, they will consider measures that would diminish or eliminate adverse financial impacts on the plan participants. Also, the transition is done gradually, without changing benefits previously earned because previously earned benefits are protected under ERISA. I believe that such an approach could improve the security of retirement benefits for Puget Sound Pilots without increasing burdens on future rate payers for past pilot services.

To gradually increase the security of retirement benefits, future Farebox plan accruals could be replaced by SEP-IRA contributions for all future pilots and current pilots below a threshold age. To protect the most senior pilots from adverse financial consequences of the transition, the threshold age would be the age below which the accumulated value of future maximum SEP-IRA contributions would be expected to exceed the value of future Farebox accruals. The exact threshold age would depend on longevity, investment return, and inflation assumptions, but would be approximately age 58 using the assumptions in Mr. Wood's projections. In this scenario, current retirees and current pilots over age 58 would continue to receive benefits under the current Farebox plan. Pilots currently younger than age 58 and all future pilots would receive Farebox benefits for past service but would receive SEP-IRA contributions in lieu of Farebox benefits for future service.

Funding of the SEP-IRA contributions can be a combination of contractual contributions and individual pilot contributions, with the contractual amount to be negotiated. The contractual amount might be different for future pilots. Because the value of Farebox accruals is a function of the pilot's age, contractual SEP-IRA contributions could also vary depending on the pilot's age.

The advantages of a gradual conversion from the Farebox plan to a defined contribution retirement program include increased security of benefits, increased portability of benefits for pilots changing careers, minimal overhead cost compared to a tax-qualified defined benefit plan, and greater predictability of cost. The greater predictability of cost would also improve the transparency of future rate cases and better align the timing of pilot services with the payments for those services.

It needs to be noted that tax-qualified defined benefit plans are very difficult to unwind. Establishing such a plan would create a permanent burden on future rate cases and rate payers. In contrast, future contributions to tax-qualified defined contribution plans can be altered or eliminated at any time.

VI. CONCLUSION

Q: Does this conclude your testimony?

A: Yes.