AMERICAN ACADEMY *of* ACTUARIES

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November 15, 2014

Actuarial Standards Board
1850 M Street NW, Suite 300
Washington, DC 20036-4601

Re: ASOPs – Public Pension Plan Funding Request for Comments

Members of the Actuarial Standards Board:

The American Academy of Actuaries[1] Public Plans Subcommittee appreciates the opportunity to provide comments in response to the Actuarial Standards Board (ASB) request for comments on Actuarial Standards of Practice (ASOPs) and Public Pension Plan Funding. The Public Plans Subcommittee provides independent and objective analysis, advice and education to stakeholders of state and local government employee benefit plans with respect to funding, financial reporting, managing financial risks and plan design. The Subcommittee also develops issue briefs, and practice notes for Academy membership. We appreciate the efforts of the ASB to develop ASOPs for the actuarial profession, including public pension plan actuaries.

Introduction to Comments

As noted in the request for comment, public pension plan funding has received increased national attention in the past few years as a result of the recent recession. The recession combined significant investment losses with declines in the revenues of the sponsors supporting public pension plans. This combination placed unusual stress on all public pension plans and their sponsors and exposed plans that were in relatively poor condition prior to the recession. The national attention has ranged from projections that many of the large plans were going to literally run out of money (some in as little as six years) to assertions that everything was fine. Examples of poor practice have been reported extensively, but the many examples of good practice have been rarely reported.

[1] The American Academy of Actuaries is an 18,000+ member professional association whose mission is to serve the public and the U.S. actuarial profession. The Academy assists public policymakers on all levels by providing leadership, objective expertise, and actuarial advice on risk and financial security issues. The Academy also sets qualification, practice, and professionalism standards for actuaries in the United States.

In the debate about what caused the current situation, sometimes all public pension plans are painted with the same brush, when in fact, there is significant variation in both the current circumstances and the causes of those circumstances. The one issue on which there appears to be agreement is when plan sponsors do not contribute at a level at least equal to the "Annual Required Contribution" as it was historically defined by GASB, the funding level of the plans suffer. This issue, it should be noted, is not controlled by the actuary. Plan sponsors that do not contribute at this level usually fail to do so either because the sponsor has set an insufficient statutory contribution rate or the sponsor decides there are other budget priorities that take precedence over the contributions to the pension plan.

The "Annual Required Contribution" allowed for a range of funding policies including some policies that were not always, in our opinion, sufficient. As the ASB noted, various organizations, including the Academy, have recently issued guidance related to funding public pension plans in an attempt to improve some current practices. The Public Plans Subcommittee will continue its efforts in this area with new projects related to disclosures and risk.

As the ASB considers additional guidance related to public pension plans, it is important to recognize that there are limits to the role that actuaries and the ASB can play. In some jurisdictions, the local governance structure established for a public pension plan grants the actuary a significant role in which the actuary recommends the annual contribution rates or contribution amounts to a governing board; and when the governing board adopts those rates, each employer is bound by law to make those contributions. In other jurisdictions, the contribution rates or the assumptions and methodology for calculating the contribution rates may be set by statute and neither the actuary nor the board employing the actuary can make a change without a change in the law. The ASB can provide standards with which actuaries must comply, but cannot regulate the actions of public pension plans or plan sponsors. Actuaries simply provide education and information so that decisions can be based on an understanding of the implications of those decisions and others can evaluate and hold decision makers accountable.

Finally, before answering the ASB's specific questions, we would like to recognize the substantial improvements included in the recent updates to ASOP No. 4 and No. 27. We believe these changes will have a positive impact on the recommendations of public pension plan actuaries and on the disclosures related to public pension plans.

1. *Public plan funding and associated actuarial valuations are less uniformly regulated than those of private sector pension plans. Actuaries may be asked by their principal to advise on funding levels. Is additional guidance needed, beyond that in the recently revised pension ASOPs, regarding appropriate public plan actuarial valuation practice to assist actuaries in performing their work and advising their principal Why or why not?*

   Yes, additional guidance could be helpful in some areas, not just for public pension plans, but also for all pension plans. In particular, additional guidance or disclosure requirements could provide support to actuaries who make appropriate comments or disclosures when the plan or plan sponsor actions may not be consistent with the actuaries' recommendations. Actuaries cannot enforce contribution levels on plan sponsors, but actuaries can provide information so that others can judge whether or not the plan or plan sponsor actions are appropriate.

Additional guidance could also help constrain some outlying practices and help principals and actuaries consider important principles in their decisions about recommended contribution levels and assessments of future risks.

2. *If yes to question 1, in what areas is additional guidance needed?*

The current guidance related to the selection of contribution allocation procedures is very limited, focusing primarily on the concept of "accumulating adequate assets to make benefit payments when due, assuming that all actuarial assumptions will be realized and that the plan sponsor or other contributing entity will make actuarially determined contributions when due." (ASOP No. 4, paragraph 3.14.1) This guidance could be made significantly more robust, as described below.

We published an issue brief in February 2014 that discussed the necessity of balancing three competing objectives: benefit security, contribution stability and predictability, and generational equity. Furthermore, we advocated principles of enhancing transparency and anticipating risk. The current guidance in actuarial standards could be enhanced by requiring the actuary to consider these three competing objectives when selecting a contribution allocation procedure. Such consideration should also be expanded beyond the scenario in which all assumptions are realized and the plan sponsor makes all contributions when due, to include (at least) a qualitative assessment of the risk that the assumptions will not be realized or the plan sponsor will not make all contributions when due. This is particularly important when the contribution allocation procedure has deferred higher levels of contributions into the future.

With the new GASB standards, the determination of an appropriate actuarially determined contribution has become of greater importance for public plans and some additional guidance could be helpful. We believe that an "actuarially determined contribution" should have certain constraints including:

- The amortization method should not perpetually produce contributions that are less than normal cost plus interest on the unfunded actuarial liability. In other words, the unfunded actuarial liability should be expected to ultimately and steadily decrease if all assumptions are realized. This principle, for example, would preclude a contribution based on a "rolling" 30-year amortization policy from being considered an actuarially determined contribution.
- The normal cost determined under an individual cost method should reflect the plan provisions applicable to each individual member. This requirement would improve the transparency of the attribution of costs to time periods.
- Actuaries should be required to calculate an actuarially determined contribution as part of a periodic actuarial valuation of a plan for funding purposes, even if it is not requested by the principal.

- Actuaries should be required to disclose a comparison of actual historical contributions to the actuarially determined contribution.

In addition, when a "spread gain" actuarial cost method is used to develop actuarially determined contributions, in order to improve the transparency of the attribution of costs to time periods, the actuary should also disclose the normal cost under an immediate gain cost method reflecting the plan provisions applicable to each individual member.

We are aware that the ASB is working on an exposure draft related to risk, and would welcome some additional guidance in this area. In particular, we believe that when managing a pension plan—including decision-making relative to the level of promised benefits, the contributions to be made, and the strategy for investing assets—it is important for plan sponsors to consider projections based on expected experience, as well as projections showing the risks of experience not meeting the expectations.

3. *If yes to question 1, should that guidance take the form of a separate public plan actuarial valuation standard or be incorporated within the existing ASOPs? Why or why not?*

   Any additional guidance generally should be incorporated into existing ASOPs. The existing ASOPs already provide a significant level of guidance applicable to public plan actuarial valuations. Creating a separate ASOP incorporating all of that guidance plus any additional new guidance could create confusion in cross referencing the different standards and ensuring that the same standards are applicable to all pension actuaries performing the same type of work. If there is a specific area of new guidance that doesn't fit in one of the current standards (e.g., risk), a separate standard could be created for that topic area.

4. *In general, the ASOPs are principles based and not rules based. As a result, the ASOPs are generally not highly prescriptive. Should the ASOPs related to public plan actuarial valuations be more prescriptive? If so, in what areas?*

   The ASOPs should remain principle-based and not rule-based. There is a wide variety of situations among public pension plans, and any attempt to create a one-size-fits-all set of rules will undoubtedly create unintended consequences. Instead, principles can be used to control practice, allowing innovation while preventing the creative interpretation of rules. To accomplish this objective, some principles in the ASOPs can be made clearer or more prescriptive.

   In addition to the principle-based guidance, the current ASOPs are prescriptive in many communication requirements. While the growth of disclosures in boiler-plate-like certifications is not particularly valuable, the addition of specific targeted required disclosures could be helpful.

5. *The ASOPs have provided guidance that has been applicable to all areas of practice in the pension community (for example, private sector, multiemployer, public sector). If you believe that additional guidance is needed for public plan actuarial valuations, should any of that additional guidance also apply to non-public section plans? Why or why not?*

   Guidance should apply to all pension actuaries engaged in a specific activity. For example, a pension actuary recommending a contribution allocation procedure for a private church pension plan should be covered by the same standard as the pension actuary recommending a contribution allocation procedure for a public pension plan. The same is true of a private-sector plan actuary developing a procedure that is intended to go beyond the statutory minimum funding requirements. It is the activity of recommending a contribution allocation procedure that should trigger the applicability of the guidance, not the fact that it is a public pension plan. If different guidance were to apply in two situations where the actuary is performing the same activity for the same purpose, it would undermine the credibility of the standards.

   Given that public pension plan actuaries may engage in certain activities far more often than other pension actuaries, the practical impact of providing guidance on those activities may primarily fall on public pension actuaries. Nevertheless, to maintain the consistency of standards applicable to all pension actuaries, any new guidance should not be limited to a subcategory based solely on the nature of the plan sponsor.

6. *The current definition of an "intended user" of an actuarial communication is "any person who the actuary identifies as able to rely on the actuarial findings" (ASOP No. 41, Actuarial Communications, section 2.7). Should the ASOPs require the actuary for public pension plans to perform additional, significant work (which would be incorporated in the guidance provided in the ASOPs) that is not requested by the principal if that work provides useful information to individuals who are not intended users? Why or why not? If so, should this requirement be extended to all pension practice areas? Why or why not?*

   While there are a variety of governance structures in different jurisdictions, public pension plans are public entities with representative Boards and established procedures for requesting information. Individuals who are not intended users can use those processes to request information that they deem useful. However, they should not be able to demand specific information from the actuary without going through the processes in place for the specific plan. The Actuarial Standards Board should not attempt to override the processes currently in place, since it cannot regulate the actions of public plans or their sponsors, who would generally not be willing to retain the actuary to perform significant additional work.

   In determining the work that the ASOPs should require an actuary to perform, the ASB should consider what is useful to intended users for the purpose of the measurement, but it is impossible to predict the perceived needs of individuals who are not intended users and may desire a measurement for a different purpose.

While there are legitimate interests of various stakeholders (taxpayers, legislators, bond-holders and plan participants) in the financial status of a public plan, the variety of individuals or groups who are not intended users and the variety of actuarial information they could find useful for a variety of purposes would be overwhelming. In an attempt to determine the information these individuals may find useful and incorporate it into the ASOPs, the ASB would essentially be selecting the information deemed useful to one set of individuals over the information useful to another set of individuals.

As we understand it, the standard for requiring actuaries to perform work not requested by the principal has always been based on the information needed by intended users given the purpose of the measurement. In the case of public pension actuarial valuations for funding purposes, the ASB could decide that the intended users, including the principal, need to know, for example, what an actuarially determined contribution rate or amount would be. Then, even if the principal did not request this information, the ASOPs could require the actuary to provide that amount. Similarly, the ASB could decide that the intended users needed projections or certain risk metrics when the purpose of the measurement is to set contributions, and then could require the actuary to provide them.

However, if intended users do not need the information based on the purpose of the measurement, then the actuary should not be required to provide additional information because other individuals may find it useful for other purposes. If the information needed by intended users for the purpose of the measurement is provided, other users should be able to evaluate the decisions of the intended users and hold them accountable.

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The American Academy of Actuaries Public Plans Subcommittee appreciates the opportunity to provide these comments and would be happy to discuss any of these items with you at your convenience. Please contact Matthew Mulling, pension policy analyst (mulling@actuary.org; 202-223-8196) if have any questions or would like to discuss these items further.

Sincerely,

William R. Hallmark, MAAA, ASA, EA, FCA
Chairperson, Public Plans Subcommittee
American Academy of Actuaries