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July 23, 2018

ASOP No. 4 Revision
Actuarial Standards Board
1850 M Street NW, Suite 300
Washington, DC 20036

SUBJECT: Comments on the 2018 Proposed Revision of Actuarial Standard of Practice (ASOP) No. 4

Dear Members of the Actuarial Standards Board:

The California State Teachers' Retirement System (CalSTRS) thanks the Actuarial Standard Board (ASB) for the opportunity to provide comments on the proposed revision to Actuarial Standard of Practice (ASOP) No. 4.

CalSTRS, with a portfolio valued at $224.9 billion as of May 31, 2018, is the largest educator-only pension fund in the world. CalSTRS serves California's more than 933,000 public school educators and their families from the state's 1,700 school districts, county offices of education and community college districts. CalSTRS administers a hybrid retirement system consisting of a traditional defined benefit, a cash balance and voluntary defined contribution plan.

CalSTRS relies on both internal actuarial staff and an outside actuarial firm, Milliman, to provide appropriate, meaningful and understandable information related to the disclosure of risk and potential variability of funding levels and contribution requirements to CalSTRS board members, policymakers, stakeholders and the public. To ensure only appropriate and meaningful disclosure is provided, CalSTRS believes ASOPs should remain principles based and should leave the details and manner to communicate disclosure elements of risk to the professional judgment of the actuary. This is especially important since, as is the case for most public pensions in the United States, CalSTRS operates in a highly visible environment and is often the focus of scrutiny from the media, policymakers, and others.

Following are our comments and concerns related to the proposed changes to ASOP no. 4.

Comment 1 - Require Disclosure of an Actuarially Determined Contribution (ADC)

CalSTRS would first like to begin by commending the ASB for proposing that an actuary performing a funding valuation should calculate and disclose an Actuarially Determined Contribution (ADC).

CalSTRS is subject to statutory limitations when it comes to setting contribution requirements to properly fund pension benefits. We believe it is important to disclose to trustees, the plan sponsor and the public whether the contributions made to a pension plan are sufficient to ensuring the proper long term funding of the pension obligations. Our funding valuation has for years compared the contributions coming into the system to an actuarially determined amount necessary to properly fund CalSTRS long term.

For this reason, the ASB should consider requiring the disclosure of an ADC determined independently of any statutory limitations even for plans for which a method is set by law.

Comment 2 – Long Standing Practice of ASOP Being Principle Based

CalSTRS would like to remind the ASB that ASOPs have historically been principles-based and have not prescribed specific actuarial practice/calculation. This philosophy is even stated in ASOP No. 1, Section 3.1.4 which says:

> “The ASOPs are principles-based and do not attempt to dictate every step and decision in an actuarial assignment. Generally, ASOPs are not narrowly prescriptive and neither dictate a single approach nor mandate a particular outcome. Rather, ASOPs provide the actuary with an analytical framework for exercising professional judgment, and identify factors that the actuary typically should consider when rendering a particular type of actuarial service. The ASOPs allow for the actuary to use professional judgment when selecting methods and assumptions, conducting an analysis, and reaching a conclusion, and recognize that actuaries can reasonably reach different conclusions when faced with the same facts.”

The proposed Section 3.11 of ASOP No. 4 directs an actuary performing a funding valuation to calculate an Investment Risk Defeasement Measure (IRDM) through a prescribed approach, directly conflicting with ASOP No. 1 and its statement that “ASOPs are not narrowly prescriptive and neither dictate a single approach nor mandate a particular outcome.” As currently written, Section 3.11 is prescriptive, prevents the actuary from exercising professional judgment and dictates a single approach.

Comment 3 - Conflict with Actuarial Code of Professional Conduct

Prior to requiring the disclosure of an IRDM as currently proposed in Section 3.11, the ASB should consider Precepts No. 4 and 8 of the actuarial Code of Professional Conduct promulgated by the American Academy of Actuaries.

Precept 4 of the Code of Professional Conduct states:

> “An Actuary who issues an Actuarial Communication shall take appropriate steps to ensure that the Actuarial Communication is clear and appropriate to the circumstances and its intended audience and satisfies applicable standards of practice.”

Precept 8 of the Code of Professional Conduct and its Annotations states:

> PRECEPT 8. “An Actuary who performs Actuarial Services shall take reasonable steps to ensure that such services are not used to mislead other parties.”
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> ANNOTATION 8-1. “An Actuarial Communication prepared by an Actuary may be used by another party in a way that may influence the actions of a third party. The Actuary should recognize the risks of misquotation, misinterpretation, or other misuse of the Actuarial Communication and should therefore take reasonable steps to present the Actuarial Communication clearly and fairly and to include, as appropriate, limitations on the distribution and utilization of the Actuarial Communication.”

As per proposed Section 3.11 of ASOP No. 4, an actuary performing a funding valuation would be required to disclose a pension obligation measure that is based either on a discount rate using US Treasury yields or rates at which the pension obligation can be settled. We believe that the disclosure of such measures is not appropriate to CalSTRS circumstances and CalSTRS intended audience. It is important to remember that California has a strong legal framework that governs and protects the accrual of pension benefits for CalSTRS members. CalSTRS pension obligation cannot be settled and are guaranteed ultimately by the State of California.

We believe that the disclosure of an IRDM will lead to the use of the measure to mislead stakeholders, policymakers, the media, pension plan participants, and the general public about the funding condition of the pension plan. The IRDM seems to be precisely the type of misuse that Precepts 4 and 8 are intended to avoid.

It is very easy to find examples in the media today where public pension plans are being accused of lying and not disclosing what some are saying is the “true” cost of pensions. In California, CalSTRS has been subject to such misleading publicity on multiple occasions. Here is an example:

> “Notice how CalPERS is choosing to value liabilities at the same rate as it expects to earn on assets. … As Nixon said, it’s the lie that gets you. CalPERS’s lies harm citizens. By linking discount rates to investment return assumptions, CalPERS and its sister pension fund, CalSTRS, are being untruthful. The lies get exposed when citizens get hit with pension deficits.”
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> David Crane, “It’s the Lie That Gets You” medium.com article, March 4, 2017

As actuaries, we understand that choosing the right measure of a pension obligation depends on the purpose of the measurement. Contrary to what some critics of public pensions have stated publicly, there is not one true measure compared to which all other measures are deceptive to the public. We urge the ASB to consider very seriously the implication of mandating the disclosure of an IRDM using a prescribed method as it is likely going to be used to mislead other parties that its purpose is to measure the true cost of the pension promise. Making it a mandated calculation will almost certainly be used as evidence that it is the only true measure of cost.

Comment 4 - IRDM is Not an Appropriate Measure of Investment Risk

As currently defined, the IRDM is not an appropriate measure of investment risk. As stated in the proposed ASOP No. 4, the purpose of the IRDM is to measure the cost to defease the investment risk for a pension plan. If this is the true purpose, then the current language would not properly measure the cost to eliminate investment risk for CalSTRS and most public pension plans.

The proposed IRDM requires the use of the unit credit cost method and would not recognize any potential future pay increases for plan participants. It is important to remember that California has a strong legal framework that governs and protects the accrual of pension benefits for CalSTRS members. CalSTRS always measures liabilities by taking into account future expected pay increases. Any disclosure of liability which does not reflect future pay increases would be underestimating the funding targets / liabilities of the plan and would not properly represent the cost of eliminating investment risk.

If the intent of the IRDM is really to determine the cost to eliminate/defease the investment risk of a plan then it needs to be one based on a cost method that does incorporate future expected salary increases – such as the Projected Unit Credit (PUC) or Entry Age Normal.

CalSTRS would like to note that ASOP No. 51 recognized this and included language in Section 3.4 stating that if the actuary were to assess plan liabilities using a lower discount rate, that it be done on a basis consistent with the basis used to assess the plan on-going liabilities. The language of ASOP No. 51, Section 3.4 says:

> "… a comparison of an actuarial present value using a discount rate derived from minimal-risk investments to a corresponding actuarial present value from the funding valuation or pricing valuation."

Comment 5 - Disclosure of Risk Belongs in ASOP No. 51

Proposed Section 3.11 of ASOP No. 4 clearly defines the IRDM as a risk measure. We believe that any examination and assessment of the investment risk belongs in ASOP No. 51, Assessment and Disclosure of Risk Associated with Measuring Pension Obligations and Determining Pension Plan Contributions.

It is worth noting that ASOP No. 51 already contains principles-based guidance to evaluating pension plans' investment risks and that it does not prescribe one method for assessing risk. Instead, ASOP No. 51 suggests various methods for assessment of risk. Any of the methods listed in ASOP No. 51 would be more generally applicable than the proposed IDRM. The language of ASOP No 51 says:

> "Methods may include, but are not limited to scenario tests, sensitivity tests, stress tests, and a comparison of an actuarial present value using a discount rate derived from minimal-risk investments to a corresponding actuarial present value from the funding valuation or pricing valuation."

It is also important to remember that the ASB just recently completed a thorough process that led to the creation of ASOP No. 51. We believe that additional time must be provided to let ASOP No. 51 operate to see how it will help improve the disclosure of risk related to measuring pension obligations and determining pension plan contributions.

At CalSTRS, we are strong believers in meaningful and appropriate disclosure of risk. We should not be required to disclose a prescriptive, arbitrary and potentially misleading measure of risk such as the IRDM and instead be given the flexibility, as currently provided in ASOP No. 51, to select the appropriate approach to disclose risk. This flexibility is necessary to ensure all of CalSTRS interested parties have the right understanding of the risk inherent in the funding of CalSTRS pension obligations. There are reasons why CalSTRS never produced a number similar to the proposed IRDM in the past. What would a CalSTRS trustee do with this information? What action would or should a CalSTRS trustee take based on learning the plan's IRDM? We believe other measures of risk better serve CalSTRS board members and California policymakers.

That is why for the last few years, even before the issuance of ASOP No. 51, CalSTRS has been producing an annual report entitled "CalSTRS Review of Funding Levels and Risks". This annual report has been produced with the intent to educate board members, policymakers and stakeholders on the risks inherent in the funding of the system. We believe this report illustrates well why actuaries must retain the ability to apply professional judgement in choosing the appropriate ways to disclose risk. For your information, a copy of the most recent report can be found at the following link:

https://www.calstrs.com/sites/main/files/file-ttachments/funding_risk_report_2017.pdf

Comment 6 - True Intent of IRDM

It is no secret to anyone that for years a certain group of individuals, including several actuaries have attempted to put pressure on various accounting and actuarial organizations to lead to the disclosure of a solvency/market value type of liability for public plans using risk free discount rates. If the real intent of the IRDM is to require the disclosure of a solvency/market value liability to satisfy certain users of actuarial reports then the ASB should not make this a disclosure requirement. Entities in need of a solvency/market value of liability have demonstrated in recent years that they can produce estimates of such liabilities for their purposes independently. They should continue to do so and actuaries should not be required to disclose such number. A mandated IRDM in a funding valuation would be interpreted as an endorsement of a measure that is frequently misrepresented as "the one true answer" of the condition and cost of a public pension plan.

Comment 7 – May Violate Fiduciary Duties

As stated earlier, California has a strong legal framework that governs and protects the accrual of pension benefits for CalSTRS members. Calculating an IRDM is a mere academic exercise that offers little to no practical value and would be of no use to CalSTRS trustees, policymakers and its stakeholders. Mandating CalSTRS to incur additional expenses by requiring its consulting actuarial firm, Milliman, to produce an IRDM as part of the funding valuation is not only a waste of public pension assets, but may also be a violation of fiduciary duties, particularly when looking at the requirement that CalSTRS operate solely in the interest of CalSTRS members.

Conclusion

CalSTRS believes that standards of practice should remain principles based and avoid imposing prescriptive requirements on actuaries. For this reason, we agree with most of the proposed changes in ASOP No. 4 except for Section 3.11. We strongly recommend against the proposal to require the disclosure of an IRDM or any other types of solvency liability measure as proposed in Section 3.11. Any such risk measures belong in ASOP No. 51. The ASB must not break from its long standing practice of letting actuaries exercise professional judgment in determining the appropriate approaches to disclose meaningful information related to the risks inherent in the funding of pension plans.

Thank you for considering our response.

Sincerely,

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CalSTRS	CalSTRS	CalSTRS