COLORADO PERA®

July 26, 2018

ASB Comments
American Academy of Actuaries
1850 M Street, NW, Suite 300
Washington, DC 20036

RE: Comments to ASOP No. 4 Exposure Draft

Members of the Actuarial Standards Board:

The Colorado Public Employees' Retirement Association (Colorado PERA) is pleased to have the opportunity to respond to the recently released Exposure Draft of a proposed revision to Actuarial Standard of Practice (ASOP) No. 4, *Measuring Pension Obligations and Determining Pension Plan Costs or Contributions*. The views shared in this comment letter are those of the staff of Colorado PERA and do not represent the views of the Board of Trustees of Colorado PERA (Board), which has not taken a position on the Exposure Draft.

Colorado PERA was formed in 1931 and administers five defined benefit pension plans [State Division Trust Fund, School Division Trust Fund, Local Government Division Trust Fund, Judicial Trust Fund, and Denver Public Schools (DPS) Division Trust Fund], two defined benefit other postemployment benefit (OPEB) plans [Health Care Trust Fund and DPS Health Care Trust Fund], three defined contribution plans, and a private purpose trust fund.

Colorado PERA's five division trust funds include close to 600 employer reporting units with approximately 207,800 active members, 257,800 inactive members and 118,500 retiree members. In addition to Colorado PERA's annual actuarial valuation, the Board requires its external actuaries to produce actuarial projections for each division and health care trust fund and also a Signal Light Report regarding the five division trust funds which forecasts the likelihood of Colorado PERA meeting its economic and demographic assumptions based on the most recent actuarial valuation results. Copies of Colorado PERA's most recent actuarial valuations and Comprehensive Annual Financial Reports are available at http://www.copera.org.

We would like to thank the Actuarial Standards Board (ASB) for considering public comments to this proposed revision and believe public comments are an integral part of the process to determine standards and related authoritative guidance. Below are our comments to the proposed revision of ASOP No. 4.

First we would like to commend the ASB for the work that has gone into the revisions included in the ASOP No. 4 Exposure Draft regarding Sections 3.14 through 3.21, and Sections 4.1 through 4.2. We note that additional detail could be included in Section 3.14, *Amortization Method*, regarding the acceptance of a layered amortization approach, which Colorado PERA employs in the determination of the Actuarially Determined Contribution for each division trust fund, as delineated in the Colorado PERA Board's Pension Funding Policy. We also would propose the inclusion of guidance regarding amortization of a surplus, as opposed to only addressing the amortization of an unfunded actuarial accrued liability. Other than those two general comments, we will defer to the actuarial firms and actuarial organizations to address the more detailed aspects of these sections.

The majority of our dissenting comments focus on Section 3.11, *Investment Risk Defeasement Measure*, (or "IRDM") included in the ASOP No. 4 Exposure Draft and our belief that this proposed "measure of investment risk" is basically flawed in concept, calculation, and application as currently described in the Exposure Draft. Below we present our assessment of the risks related to the IRDM from our viewpoint as a **public pension plan** that depends upon actuarial expertise and judgement for annual valuation and disclosure purposes. We intend our comments to bring to light specific risks that arise from the requirement of this measurement; risks such as:

- Reasonable assumptions and methods,
- Defendable disclosures,
- Legal interpretations, and
- Actuarial reputation.

Reasonable Assumptions & Methods Risk

Inappropriate Actuarial Cost Method

The unit credit cost method is rarely used for public pension plans regarding funding valuations and is not allowed by GASB for use in valuations for accounting and financial disclosure purposes. Therefore, Colorado PERA staff believes that this cost method is inappropriate for the proposed use, within the public pension plan arena.

Inappropriate Demographic Assumptions

Section 3.11 allows for use of the same non-economic assumptions as those applied in a plan's funding valuation. Based on the description of the discount rate required by this proposed section of ASOP No. 4, the calculation appears to mirror the determination of a settlement liability. However, plan members who no longer earn future service credits or pay increases behave much differently than members in an "ongoing" plan. Therefore, using assumptions intended for an "ongoing" plan in the determination of the IRDM, likely, would not be appropriate.

Unrealistic Discount Rate

Unlike private sector plans, pension plans that serve public entities and thus, large populations of public employees, are typically considered ongoing entities as are the governments they benefit. Therefore it only would be appropriate to value the liabilities of these public pension plans reflecting an ongoing and long-term perspective. With respect to public sector pension plans, Colorado PERA believes the limited choices of discount rates as prescribed by Section 3.11 of the ASOP No. 4 Exposure Draft, are too narrowly defined, reflect only a market-value or settlement rate, and are not representative of a discount rate that would accurately value funding liabilities of an on-going plan.

Purpose of the Measurement

As mentioned in a number of ASOPs, a primary consideration in the selection of actuarial methods and assumptions should reflect the "purpose of the measurement". The IRDM, as delineated in the ASOP No. 4 Exposure Draft, is described as an investment-risk measure. However, as noted above, the assumptions and cost method mandated for use in the calculation of the IRDM do not produce a number that is useful in measuring ongoing investment risk. Therefore, Colorado PERA does not believe the purpose of the measurement, as stated, is being met. We do not believe the proposed IRDM would add value for the users of our funding valuation or contribute pertinent information upon which to base long-term funding decisions. The inclusion of this metric in the final version of ASOP No. 4 would simply be an expensive requirement with no real value to the users.

Defendable Disclosure Risk

Challenges of Explaining Two "Right" Numbers

If the ASOP No. 4 Exposure Draft is adopted as written, given the mandated nature of the IRDM, Colorado PERA is very concerned there will be confusion as to which pension liability value is accurate. Additionally, the issuance of the new pension liability likely would be misinterpreted as a recommendation of the actuary despite any disclosure to the contrary. We believe this approach will unnecessarily cause confusion and misunderstanding among the memberships, employers, legislators, and tax-payers who embody the stakeholders of all public pension plans.

Narrow Viewpoint

The IRDM, as suggested by its name, mainly focuses on investment risk. If the IRDM is truly a measure of risk that should be taken seriously by all pension plans, it should reflect and/or test other aspects of risk. The IRDM also should reflect the expected exposure to investment return volatility inherent in a plan's actual fund portfolio, not be restricted to the use of an arbitrarily prescribed rate of return that has no relationship to the portfolio. Colorado PERA views the IRDM approach as too narrow-minded and believes a more broad-based approach has been sufficiently reflected in the risk assessments suggested in ASOP No. 51, *Assessment and Disclosure of Risk Associated with Measuring Pension Obligations and Determining Pension Plan Contributions.*

Bond Rating Agencies

Many bond rating entities currently determine their own alternative values regarding public pension plans. Therefore, we believe it is likely that one type of "user" of the IRDM information would simply ignore the metric and use the calculations determined by their own organization applying their own methods and assumptions. This would deem the determination of an IRDM practically useless and the confusion it likely will cause among other readers of the actuarial funding valuations (all public plan stakeholders), pointless and unnecessary.

Legal Interpretation Risk

The Legalities of Settlement

Identifying the IRDM as a "settlement measure" may, in effect, limit its relevance within the public pension plan sector. As generally noted in a number of court cases across the United States, it is illegal for most public pension plans to freeze benefit accruals or to settle obligations. The presentation of such a metric in actuarial reports may increase the risk of misuse and/or misinterpretation by implying potential for, most commonly, an impermissible action.

Actuarial Reputation Risk

The ASOP Approval Process

Colorado PERA would like to comment on the apparent and intentional deviation from well-established ASB procedures. Within the characteristic process of the review and revision of an ASOP, the ASB's Pension Committee typically would review and draft any new guidance related to pensions. This step was noted in the review process of the current ASOP No. 4. However, following the ASB's July 2014 *Request for Comment* regarding public sector actuarial practices, the ASB opted, instead, to form a smaller Pension Task Force to review the responses and make suggestions. Colorado PERA questions the ASB's reasoning for deviation from their well-established process.

Recently Revised ASOP No. 4

Perhaps more important, than the deviation from typical procedures as described above, was the notable hasty revisiting of the review of ASOP No. 4. The more traditional review of ASOP No. 4 which took place between January 2011 and December 2013 apparently was discounted as insufficient given the commencement of the latest process of review which commenced almost as soon as the revised ASOP No. 4 was adopted.

Recently Adopted ASOP No. 51

ASOP No. 51, "*Assessment and Disclosure of Risk Associated with Measuring Pension Obligations and Determining Pension Plan Contributions*", was recently adopted as of September 2017 and effective for funding valuations (and other actuarial work-product) performed on or after November 1, 2018. Colorado PERA believes a more appropriate measure of investment risk can be found in ASOP No. 51, which allows for choices between many possible methods of assessing risk related to the pension plan in question.

Conclusions

In the world of public pension plans, governing boards and system staff struggle each day with education of and communications to our stakeholders. We are constantly working toward the defined goals of ensuring transparency and accountability while promoting contribution rate stability and intergenerational equity. In the collective opinion of the staff at Colorado PERA, the hasty and seemingly urgent need for yet another liability measurement, a settlement measurement, is a distinct culmination of risk on every level. We are speaking to the risk of misinterpretation and misuse, inaccurate and inappropriate calculations, impermissible or illegal determinations, and reputational risk for the actuarial profession in general, particularly for those providing actuarial expertise and judgement in the production of annual funding valuations and disclosure information for public pension plans.

As pointed out above, there are a few items included in the ASOP No. 4 Exposure Draft that we find appropriate with the exception of Section 3.11, regarding the required calculation and disclosure of an IRDM. However, Colorado PERA would encourage a more thoroughly researched and appropriately vetted approach in the determination of revisions ultimately to be included in ASOP No. 4.

Again, we appreciate the opportunity to comment on this project. Should you have any questions regarding these comments, please feel free to contact me at rbaker@copera.org.

Sincerely,

Ron Baker

Ron Baker

Interim Executive Director, Colorado PERA