Comment #34 – 7/31-18 – 8:19 a.m.

I am Leon F. Joyner, Jr., FCA, ASA, MAAA and EA. I have worked with many types of retirement plans in my career. Since 1990, I have been predominately working with public sector retirement systems. I thank the ASB for this opportunity to comment on the exposure draft of a proposed revision of ASOP No. 4, *Measuring Pension Obligations and Determining Pension Plan Costs or Contributions*. In general, I agree with many of the proposed revisions. The ASB has received many well-written responses. Therefore, my comments will focus on two major areas of concern for me and some of the clients I represent.

My comments include responses to the two questions asked in the cover memo as well as further details on my two major areas of concern.

Responses to Questions

The following are my responses to the questions asked by the ASB:

1. Section 3.11, Investment Risk Defeasement Measure, requires the calculation and disclosure of an investment risk defeasement measure when the actuary is performing a funding valuation. The guidance allows for discount rates to be based upon either U.S. Treasury yields or yields of fixed income debt securities that receive one of the two highest ratings given by a recognized ratings agency. Are these discount rate choices appropriate? If not, what rate choice would you suggest?

   Since this is a risk measurement, standards for determining this measure should be included in the risk ASOP not the funding ASOP. If the ASB insists on this measure in the funding ASOP, I believe that the standard should be less prescriptive, so that additional choices are available including the option to not determine this liability in situations where defeasement is not a realistic option either by statute or by practicality.

2. Under certain circumstances, section 3.20, Reasonable Actuarially Determined Contribution, requires the actuary to calculate and disclose a reasonable actuarially determined contribution. Do the conditions in this section describe an appropriate contribution allocation procedure for this purpose? If not, what changes would you suggest?

   I support the requirement for this calculation and disclosure. However, I believe that certain restrictions on the actuarial cost method (i.e. the banning of "ultimate EAN") are not needed in light of the other restrictions on the contribution allocation procedure specifically on amortization methods in section 3.14. However, if the restrictions on actuarial cost methods (particularly the banning of ultimate entry age) are included in the final ASOP, then a transition period should be provided to allow plans that currently use a future banned method to come into compliance without significant disruption in their budgeting process.

Comments on Major Issues with the Exposure Draft of the Proposed Revision

Investment Risk Defeasement Measure

- I suggest that investment risk defeasement measure be defined in section 2. Since it is unclear to me the ASB's intent for this measurement, I leave the drafting of a definition to the ASB to add clarity. Regardless of the definition, Section 3.11's first sentence should be modified as follows, "If the actuary is performing a funding valuation, the actuary should calculate and disclose an investment risk defeasement measure unless such measure is inconsistent with statutory obligations or practical realities and therefore prone to misunderstanding and potential abuse..."

- Section 3.11: In addition to the comment above (the proposed addition of a definition of investment risk defeasement measure), I believe that this section should be less prescriptive and take into account the possibility of using other approaches that in the actuary's professional judgment are consistent with the purpose of this measurement including not providing this determination in situations that make no sense either statutorily or practically. This revision could potentially reduce both the amount of additional work required and the possibility of confusion for the user. One approach to implementing this suggestion would be to revise the end of (c) along the following lines.

  "Examples of discount rates that the actuary could use include:

  1. U.S. Treasury yields;
  2. Current liability discount rates;
  3. rates at which the pension obligation can be effectively settled (either statutorily or practically);
  4. rates published by the PBGC for plan terminations;
  5. rates implicit in an annuity purchase quote from an insurance company; or
  6. In situations where liabilities have a direct relationship to a market index that is not described above, the discount rate should reflect that relationship."

- Section 3.11: Plans may not be able to defease investment risk due to statutory requirements to maintain the plan on an ongoing basis, as well as statutory restrictions on investments. The standard should provide context (or the option to not perform the calculation) for calculating the investment risk defeasement measure when investment risk cannot be defeased. I also think we should require stronger language about the appropriateness and correct use of such a measure. Since the statement itself indicates that this measure may not have a place in the real world why do we believe it is appropriate to charge our clients for a number other parties may want for their own purposes. The inclusion of this measurement (as a requirement when doing a funding valuation) will lead to confusion and uncertainty as to

what actuaries are actually trying to report on behalf of our clients. If this calculation is to be required, it should be under ASOP 51 not ASOP 4.

Banning Ultimate Entry Age Normal

- Section 3.20(b): I do not believe that the restrictions on the actuarial cost method are necessary or appropriate. The banning of "ultimate EAN" will create disruption for many entities. The ban also removes an option for plan sponsors to use in correcting deficiencies in plan design that were enacted many years ago and which they are statutorily stuck. Please note the following discussion and description of the use of "ultimate EAN":

- An essential part of the public sector budgeting process is that large budget items, including pensions, should have a level cost pattern from year to year to the extent possible. Many actuaries and entities have recognized the importance of this requirement and structured a methodology for allocating pension contributions to time periods so that, if the actuarial assumptions are exactly realized, the required contributions will remain level as a percent of pay from year to year.

  Fundamentally, the required contribution has two components:

  - Normal Cost – The allocation to the coming year of pension costs for active employees in that year.

  - Amortization of the Unfunded Actuarial Accrued Liability (UAAL) – The coming year's payment toward pension costs allocated to prior years for which assets are not yet on hand.

  The Entry Age Normal (EAN) actuarial cost method determines the Normal Cost for an individual by calculating the level percent of pay that, if contributed each year over that person's career, would accumulate with interest to the amount projected to be needed to pay that person's pension benefits, and multiplying that "Normal Cost rate" times the person's current pay. Clearly, that produces the desired outcome with respect to each individual – a level percent of pay Normal Cost from year to year. Where there is a single plan of benefits applicable to all service for all employees, the total Normal Cost – the summation of the individual Normal Costs – will also remain essentially level for the group, if the distribution of hire ages and retirement ages is stable. Further, each time there is a termination of employment (due to retirement, death, disability, or other termination), there will be no change in the total Normal Cost rate if the replacement employee is hired at the same age as the age at hire of the terminating employee.

  A complication arises if the plan of benefits is not the same for all service for all employees. In that circumstance, the Normal Cost rate will change if the terminating employee is in Plan A and the new hire is in Plan B. If Plan A is more generous, then there will be a tendency for the Normal Cost rate to decline as a percent of pay over time, as Plan A employees terminate and are replaced by Plan B employees. This no longer meets the level funding objective.

  This problem is addressed by determining the Normal Cost as though Plan B, the plan applicable to new hires (so-called "replacement lives"), covered everyone. In the case where Plan B is less generous, that produces a lower Normal Cost than reflecting each person's actual plan. With that variation on EAN, there is once again a level Normal Cost.

  Of course, an essential requirement of any typical actuarial cost method is that the present value of all future benefits for existing participants must be matched by the value of assets on hand plus the present value of future required contributions. The reduction in the current and future Normal Cost for Plan A people who are assigned a Plan B Normal Cost must therefore be offset by an increase in the UAAL that has the same present

value. For a plan where the UAAL is routinely amortized as a level percent of pay, the end result is exactly what is desired. Each of the two components of the required contribution is a level percent of pay, so the total is as well. Whether the required contribution for the coming year is higher or lower as a result depends on a number of additional factors. Eventually, however, all benefits need to be funded, so this is a timing effect only.

If the ASB proceeds with its plan to ban "ultimate EAN" then the ASB should include a transition period such that, the actuary may transition to an acceptable method over a period up to 10 years to prevent disruption in setting contribution rates provided that such a transition period does not conflict with making required benefit payments.

Thank you for your consideration of these comments.