Comment #4 – 7-3-18 – 8:12 p.m.

To: The Actuarial Standards Board

From: Ken Steiner, FSA

Subject: Comments on ASOP No. 4 Revision

Date: July 3, 2018

I am a retired pension actuary. The comments below are submitted solely on my behalf. These comments relate primarily to Section 3.14, Amortization Method.

Background

Funding of public pension plans is a good news/bad news story. The good news is that the general actuarial pension plan funding process, involving periodic calculation of an actuarially determined contribution (ADC), is for the most part, a self-correcting process. If assumptions about the future are too optimistic, future ADCs will increase over time as they are determined in subsequent actuarial valuations. If assumptions about the future are too conservative, subsequent years' ADC's will decrease, all things being equal. The bad news is that this self-correcting process can be defeated (or unreasonably delayed) if:

1. the plan sponsor contributes less than the ADCs,
2. the cost of periodic benefit improvements is amortized over unreasonably long periods
3. overly optimistic assumptions are used and subsequent years' ADCs are developed by over-smoothing the resulting actuarial losses or increases in unfunded actuarial liability resulting from changes in assumptions,
4. overly optimistic assumptions are used and then are subsequently changed with the associated increase in Actuarial Accrued Liability amortized over an unreasonably long period.
5. Some combination of the items above

In "optimistic assumption/over-smoothing" situations, sponsor contribution stability is frequently stressed at the expense of participant security and "intergenerational equity." I believe that it is important for the revised standard to provide more definitive and stronger guidance to actuaries in Section 3.14 in order to achieve the intended balance referred to in Section 3.17 d.

Comments and Suggestions

As currently worded, I believe the guidance provided in Section 3.14 is unclear and insufficient. It should require that the gain/loss (or change in unfunded actuarial accrued liability associated with a change in assumption or method) since the previous valuation be calculated in each actuarial valuation and each such separately determined "gain/loss" or "assumption/method" amortization base" be fully amortized over a reasonable period in a reasonable manner, without regard to how other amortization bases may be amortized. Consistent with existing language in Section 4.1s, "the remaining balance to be amortized, the remaining amortization period, and the amortization payment included in the… actuarially determined contribution for each amortization base [should be disclosed in the valuation report containing a determination of the Reasonable Actuarially Determined Contribution under Section 3.20].

While the ASB may not want to prescribe specific "reasonable" periods for amortization of actuarial gains/loss bases or changes in assumptions/methods bases, I recommend the guidance suggest an amortization period no longer than the weighted average future expected lifetime of active plan participants (approximately the ratio of the actuarial present value of future salary divided by the current salary of active plan participants), or a period of 15 years, if greater.

The guidance should also require that amortization periods used for actuarial loss bases or increases in actuarial accrued liability from assumption/method change bases be no shorter than periods used to amortize actuarial gains or decreases in actuarial accrued liability from assumption/method changes. In addition, the method of amortization should generally be the same, or at least not result in slower recognition of actuarial losses/increases in actuarial liability resulting from assumption changes.

The actuary should be encouraged to use historical data for the purpose of establishing amortization bases for this purpose, but if such data does not exist or is not easily obtainable, the actuary should be permitted to apply this new requirement on a prospective basis.

While pension actuaries are accustomed to maintaining separate amortization bases for different sources of unfunded actuarial accrued liability, I would not necessarily have a problem with a reasonably designed alternative approach that focused on total accumulated gain/losses (assumption/method change) measured as a percentage of total AAL. Under this alternative, there could be no gain/loss amortization (recognition in current ADC) if total gain/losses fell inside a small corridor when measured as a percentage of the plan's AAL, but amortization (percentage recognized in the current ADC) would increase incrementally as the total accumulated gain/loss increased as a percentage of UAAL.

Utilizing either the individual amortization base approach or the alternative increasing recognizing corridor approach based on total accumulated gain/losses, I believe it is important for Section 3.14 of the revised standard to provide guidance that does a better job of balancing plan sponsor desires for contribution stability with increased participant security and intergenerational equity.

Thank you for your consideration of these comments/suggestions.