PUBLIC PENSION
FINANCIAL FORUM

Public Pension Financial Forum
c/o Ohio Public Employees Retirement System

277 E. Town Street

Columbus, OH 43215

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

Dear Board and Staff:

The Public Pension Financial Forum (P2F2) is pleased to have the opportunity to respond to the 2018 Proposed Revision of Actuarial Standard of Practice (ASOP) No. 4, *Measuring Pension Obligations and Determining Pension Plan Costs or Contributions*.

P2F2 was formed in 2004. The purpose of this organization is to promote excellence in public pension plan financial operations, provide educational programs of current interest to the membership, promote the exchange of ideas concerning financial operations and reporting between public pension plans, and to foster sound principles, procedures and practices in the field of public pensions related to the financial operations of such plans. Membership is open to any finance employee of a public pension who supports the purposes of P2F2. The organization currently has 325 members representing 130 employee benefit plans, offering defined benefit, defined contribution and hybrid plans.

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. Attached are comments to the proposed revision of ASOP No. 4 that are of interest to our membership for your consideration.

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 and perhaps 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 organizations, as well as individual public pension plans/systems 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 **as viewed by the public pension plans** that depend 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

There are certain actuarial cost methods that generally are considered inappropriate for the public sector retirement plans. One of these methods is the unit credit cost method, which is prescribed for purposes of determining the proposed IRDM metric within the ASOP No. 4 Exposure Draft. As evidence to our statement, **this 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.

Inappropriate Demographic Assumptions

Many of the demographic assumptions used in the funding valuation for active participants, such as future retirement rates, are not reasonable for use in a valuation of a plan that does not recognize future eligibility and benefit service accruals or future pay increases. Members who no longer earn future service credits or pay increases behave much differently. Although Section 3.11 allows for use of the same non-economic assumptions as those applied in a plan's funding valuation, **using assumptions intended for an "ongoing" plan in the determination of the IRDM would not be appropriate**. A unique set of assumptions would need to be developed for the determination of the IRDM.

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, the P2F2 Board 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. Additionally, the prescribed discount rate introduces material volatility in the IRDM on an annual basis that is unrelated to improvements or setbacks in a plan's actual funded health. Rating agencies that calculate alternative values based on a market indexed rate have expressed the need to "filter" out this impact when assessing annual changes in value or making comparisons between plans with different measurement dates. We believe this discount rate volatility also would be an issue for any user of the IRDM.

Purpose of the Measurement

A primary consideration in the selection of actuarial methods and assumptions, as emphasized in ASOP Nos. 4, 27 and 35, 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. Its only reasonable use or purpose is as an estimate of the cost of settling the obligation regarding accrued benefits of the plan. Therefore, the P2F2 Board **does not believe the purpose of the measurement, as stated, is being met**, but rather the IRDM is a metric of the cost of avoiding "investment risk", and not a true assessment of "investment risk". 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, the P2F2 Board 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**, such as unexpected fluctuations in plan funding, recognized longevity improvements, variations in salary scale, and unanticipated plan experience related to retirements, terminations, and/or disabilities. 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. The P2F2 Board 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

We understand that there are bond rating agencies and perhaps financial economist that may find a settlement, or "market value", metric, such as the IRDM, useful; however, many bond rating entities currently determine their own alternative values. Based on our understanding, their estimated values use methods and assumptions that vary from those prescribed in proposed ASOP 4. 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

The P2F2 Board would like to comment on the apparent and **intended 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 of the current ASOP No. 4, within the 2011 – 2013 review and adoption/revision process. 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. Although the formation of a task force is an acceptable (but not often employed) practice, the ASB substantially adopted the Pension Task Force suggestions for inclusion in the ASOP No. 4 Exposure Draft. P2F2 questions the ASB's reasoning for deviation from an otherwise well-established process.

Recently Revised ASOP No. 4

Perhaps more important than the deviation from typical procedures as described above; was the **notable 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. In the general opinion of the P2F2 Board, **a more appropriate measure of investment risk** can be found in Section 3.4 of this ASOP No. 51, which states,

> "Methods may include, but are not limited to scenario tests, sensitivity tests, stochastic modeling, 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".

If the IRDM is such a necessary measurement of investment risk to drive the inclusion of its determination in ASOP No.4, then why was it not included in the more appropriate ASOP No. 51, which has the words "*Assessment and Disclosure of Risk Associated with Measuring Pension Obligations*" in its title, rather than an ASOP focused on measuring pension obligations for funding purposes?

ASOPs, Generally Non-Prescriptive

As promulgated by ASOP No.1, the **ASOPs are intended to be principle-based, and not prescriptive**. As specifically stated in ASOP No. 1, Section 3.1.4,

> "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."

This ideal does not appear to be reflected in Section 3.11 of the AOSP No. 4 Exposure Draft, as the description of the determination of the IRDM is quite prescriptive.

IRDM in Conflict with Precept No. 4 and No. 8

Implying the IRDM, as currently described in the ASOP No. 4 Exposure Draft, is to be determined as a "settlement measure", the presentation of such a metric in actuarial reports may invite misuse and/or misinterpretation by others. This could create a significant liability for actuaries signing such reports in terms of their **responsibilities detailed under Precept Nos. 4 and 8 of the *Code of Professional Conduct***. These Precepts state that the actuary in question must take reasonable steps to ensure their actuarial communications are clearly appropriate to the circumstances and their intended audience and satisfy applicable standards of practice (Precept No. 4) and also to ensure that their services are not used to mislead other parties (Precept No. 8).

The notable change in ASOP procedures, regarding the development of the Exposure Draft, alone may be enough to drive doubt into the process by which ASOPs are developed and updated. Considering the five items presented above, the adoption of the Exposure Draft as currently proposed could be viewed by those who depend upon input from the actuarial profession as a solid basis for diminished confidence in and credibility of the ASB, the ASOPs, and the actuarial profession in general, thereby inciting actuarial reputational risk.

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 P2F2 Board, the seemingly urgent need for yet another liability measurement, a settlement measurement, that is determined through the prescribed use of an actuarial cost method generally considered inappropriate for public pension plans, in concert with the use of a non-applicable discount rate for an ongoing entity, 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, 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, the P2F2 organization 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 additional questions regarding these comments, please feel free to contact our organization by emailing Karen Carraher at kcarraher@opers.org.

This response was prepared by a collective effort of the P2F2 Board. By our e-mail submission, the P2F2 Board of Directors substantially agrees with the views in the form presented in this response. However, there are some areas where one or more P2F2 directors may have a slightly different perspective which will be shared with the Actuarial Standards Board in their systems' separate responses to the proposed revision.

Sincerely,

Karl Greve

P2F2 President