STATE OF CALIFORNIA

California Actuarial Advisory Panel

March 20, 2020

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

SUBJECT: ASB COMMENTS: ASOP No. 4, Second Exposure Draft

The California Actuarial Advisory Panel (CAAP) supports the ongoing improvement of Actuarial Standards of Practice (ASOPs) and appreciates the opportunity to provide input to the Actuarial Standard Board (ASB) on the second exposure draft for proposed ASOP No. 4 changes.

The CAAP was created with the passage of California Senate Bill 1123 in 2008 and consists of eight public sector actuaries appointed by public officeholders and agencies. Pursuant to California Government Code section 7507.2(a):

> "… the panel shall provide impartial and independent information on pensions, other post-employment benefits, and best practices to public agencies…."

As members of the CAAP, our background is in public plans, and many of our comments are made from that perspective.

The CAAP provided comments on the First Exposure Draft of ASOP No. 4 on June 25, 2018. Our comments on the Second Exposure Draft are divided into sections corresponding to the draft.

Section 3.11 – Low-Default-Risk Obligation Measure (LDROM)

1. We believe the LDROM is much more appropriately covered by ASOP No. 51 (Assessment and Disclosure of Risk Associated with Measuring Pension Obligations and Determining Pension Plan Contributions). We made this point in our comment letter for the first disclosure draft but it seems more obvious now that the word "Risk"

is part of the LDROM. ASOP No. 51 has been in force for less than two years, and we encourage the ASB to give ASOP No. 51 time to be fully reflected in actuarial practice.

In light of the inclusion in ASOP No. 51 of a risk measure that is identical to the proposed LDROM, we believe it is redundant and overly prescriptive to add a mandatory requirement to ASOP No. 4 like the LDROM.

If the requirement is retained, we strongly urge the ASB change the recommendation of the LDROM from “should” to “should consider,” consistent with ASOP No. 51.

2. We agree with allowing use of any immediate gain actuarial cost method in complying with section 3.11 and appreciate that the ASB incorporated this appropriate additional flexibility. However, in the first paragraph of section 3.11, the LDROM is described as an “obligation measure of *benefits earned* as of the measurement date” [emphasis added]. That description is inconsistent with the fact that some immediate gain methods (e.g., Entry Age Normal) do not measure the value of benefits earned but rather measure the value of costs accrued. For that reason, the words “benefits earned” should be changed to “benefits earned or costs accrued.” Note a comparable edit should be made to the next to last paragraph of section 3.11 as well as section 4.1(o)(4). Furthermore, as discussed in our next comment, the word “obligation” should be deleted in this sentence, leaving “… a low-default-risk measure of the benefits earned or costs accrued as of the measurement date.”

3. As to the name of this measure, consistent with our previous comment, we recommend removing the term obligation, changing the name to Low-Default-Risk Measure (LDRM). When referring to a specific, quantified measure “obligation” generally refers to a present value of some form of accrued benefit, whether based on current salaries or projected salaries (as in the accounting measures ABO and PBO). In contrast, as discussed just above, LDROM can be based on any immediate gain method, and so can measure the value of either accrued benefits or accrued costs. Removing the word “obligation” from the name of this measure and so using the more general term, “Low-Default-Risk Measure” removes the possible inference or presumption that this value necessarily measures accrued benefits.

4. The first sentence of the second paragraph of section 3.11 should be changed from "...pattern of benefits…" to "…pattern and amount of benefits…" Furthermore, this paragraph should also have a sentence that says, "The actuary should not consider benefit payment default risk or the financial health of the plan sponsor when selecting the discount rate." These two changes will make this paragraph consistent with our understanding of how the appropriate discount rate would be selected.

5. We agree with including discount rate alternatives and appreciate the ASB showing options.

Section 3.14 – Amortization Method

We appreciate and agree with the changes to section 3.14, in particular the reference to amortization bases.

Section 3.16 – Output Smoothing Method (and related disclosures under Section 4.1(t))

We appreciate and agree with the changes to section 3.16. However, we believe section 4.1(t) should be amended to be consistent with section 3.16 from:

> "a description of any output smoothing method used. Additionally, the actuary should disclose an actuarially determined contribution without output smoothing, if calculated;"

to:

> "a description of any output smoothing method used. Additionally, the actuary should disclose the corresponding actuarially determined contribution without output smoothing…"

Section 3.19 – Implications of Contribution Allocation Procedure or Funding Policy (and related disclosures under Section 4.1(y))

We believe the three requirements found in section 3.19 should apply to all funding policies. Accordingly, we recommend the following revisions to the third and fourth sentences of section 3.19 from:

> "If the **contribution allocation procedure** results in an **actuarially determined** contribution that is less than the **normal cost** plus interest on the unfunded **actuarial accrued liability**,

> the actuary should estimate how long before the **actuarially determined** contribution is expected to exceed that amount. If contributions are set by law or by a contract (such as a collective bargaining agreement), the actuary should estimate the period over which the unfunded actuarial accrued liability is expected to be fully amortized."

to:

> "If the **contribution allocation procedure** or other funding policy results in a contribution that is less than the **normal cost** plus interest on the unfunded **actuarial accrued liability**, the actuary should estimate how long before the contribution is expected to exceed that amount. The actuary should estimate the period over which the unfunded actuarial accrued liability is expected to be fully amortized."

A comparable edit should be made to section 4.1(y) from:

> "if applicable, that the contribution allocation procedure results in an actuarially determined-contribution that is less than the normal cost plus interest on the unfunded actuarial accrued liability and, in that case, how long before the actuarially determined contribution is expected to exceed that amount, in accordance with section 3.19;"

to:

> "if applicable, that the contribution allocation procedure or other funding policy results in a contribution that is less than the normal cost plus interest on the unfunded actuarial accrued liability and, in that case, how long before the contribution is expected to exceed that amount, in accordance with section 3.19;"

Section 4.1(v) – Required Disclosures in an Actuarial Report

This paragraph could be interpreted to require comments on how each of the considerations in section 3.17 apply to each of the contribution allocation procedure methods described in section 3.21. This could be unduly burdensome. We agree with the idea of requiring comment on the significant considerations with respect to the contribution allocation procedures but don't think it's necessary to require comment on all considerations, consequently we suggest the following change:

> "a description of how the pertinent considerations in section 3.17 have been taken into account…"

Thank you for considering our responses and please do not hesitate to contact us if you have any questions.

Sincerely,

Paul Angelo
Chair, California Actuarial Advisory Panel

cc: Panel members
John Bartel, Vice Chair
Ian Altman
David Driscoll
David Lamoureux
Graham Schmidt
Todd Tauzer
Scott Terando