November 14, 2014

Via email: comments@actuary.org

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

Dear ASB Members:

Attached are my comments in re Request for Comments – ASOPs and Public Pension Plan Funding and Accounting

The ASB Procedures Manual (page 12, Section V, item E) indicates that the Chairperson of the ASB may authorize public hearings. Factors that may lead to public hearings include (V.E.1b) the anticipated level of controversy; and (V.E.1c) the significance to the profession of the guidance contained in the proposed standard. I believe that these factors are present in this instance and thus urge the ASB Chair to hold such hearings. I hope that I will be offered the opportunity to testify.

Very truly yours,

Jeremy Gold

Comments in re Request for Comments – ASOPs and Public Pension Plan Funding and Accounting

Jeremy Gold

Thank you for taking up the issue of ASOPs and public pension plan funding and accounting and for the opportunity to present my views. Your request asks several questions. I want to address just one of these and make one short comment about another:

3. *If yes to question 1, should that guidance take the form of a separate public plan actuarial valuation standard or be incorporated within the existing ASOPs? Why or why not?*

I believe that a separate public plan standard is called for.

Other commentators who take this position have pointed to the very great environmental differences between public and corporate pension plans including governance, regulation, sponsorship, administration, interested parties, third party guarantors, the importance of intergenerational equity, plan design, etc.

Arguments against the need for a separate standard point to the common properties of defined benefit pension plans and the role of actuaries performing pension valuations. Because ASOPs are principles based, they say, the conceptual commonalities should be sufficient to imply that the work of actuaries with respect to both public and private plans can be governed by singular standards.

In a world of pure principles and concepts, I would have to agree. I would like to think that pension actuarial work is similar in all contexts. But the ASB does not write concept statements. ASOPs are, by name and definition, standards of Practice.

When we talk about pension practice in re: funding and accounting, we are talking about the application of methods and assumptions to the measurement of liabilities and costs. Although practice in the public and corporate spheres developed from common roots and, although several decades ago the liabilities and costs developed by actuaries practicing in the two areas were similar, environmental differences have, over the last four decades, led to an enormous divergence of practice in respect of methods and assumptions.

We have long acknowledged that differences in methods and assumptions could lead two actuaries to develop very different measures of liabilities and costs. Several decades ago, however, if we had looked at the range of liabilities and costs developed by a sampling of public and corporate actuaries, we would have seen considerable overlap between the two disciplines. Today, the range of results is clearly marked as follows: liabilities and costs (for funding and for accounting) developed by corporate actuaries are almost universally greater than those developed by public plan actuaries for the same plan provisions and population demographics. It is not at all unusual for those employing corporate plan methods and assumptions to arrive at annual costs that are twice or more as great as those employing public plan methods and assumptions. And, I hasten to add, both groups of actuaries are close to universally compliant with our existing ASOPs.

Many would point out that the differences are due to environmental factors and I agree. But our profession cannot control the environment. We can only influence the activities of practicing actuaries and our primary tool is our standards of practice.

The practices now differ in methods and assumptions. For accounting, public plans follow GASB and use or will shortly use entry age normal; corporate plans follow FASB and use projected unit credit. Amortizations of unfunded liabilities in the corporate sector are flat dollar and over relatively short periods of time; in the public sector, amortizations are usually designed to be a constant percentage of assumed rising payrolls, with the result that costs are significantly backloaded and too often amount to less than the interest on the unfunded.

Assumption differences are at least as important as differences in methods. Public plans discount future cash flows using the expected return on plan assets, currently in the 7.5% to 8.0% range; corporate plans use discount rates based on bond yields, currently between 4.0% and 4.5%. With durations for younger active lives often in excess of 20 years, the difference in liabilities can be as great as 2:1.

Baseball and cricket have common roots, as do rugby and football. We would not expect rule books, coaches, referees to treat baseball and cricket similarly just because of their common roots. When the issue is practice standards, practice realities have to trump common roots and overcome historical allegiance to principles that no longer drive practice.

I have chosen to focus on this question #3 because it is a decision that I believe the ASB will have to make before it wrestles with issues related to the other questions. I believe that trying to stretch one set of standards across two divergent disciplines will make the ASB's job more difficult and will result in standards in both areas that are either too general and too vague to influence practice or in standards that are extremely cluttered with material that will be irrelevant to each of the practice areas in turn.

4. *In general, the ASOPs are principles based and not rules based. As a result, the ASOPs are generally not highly prescriptive. Should the ASOPs related to public plan actuarial valuations be more prescriptive? If so, in what areas?*

The ASB has repeatedly contrasted principles based versus prescriptive, almost as though they were antonyms, as though they were opposite ends of a range into which ASOPs must fall. Further, the ASB has clearly favored principles over prescriptions. Today, the ASB asks whether the circumstances surrounding pension standards might require some movement toward prescription and, presumably, away from principle.

But the terms are not antonyms. Standards can be written that are principles based and prescriptive or practice based and not prescriptive. The FASB has always been principles based and has always written standards that are much more prescriptive than those that the ASB has written for pensions.

In the absence of strong third-party regulation such as that provided by the FASB and the Congress in the corporate area, we must have standards applicable to public pension practice that are more prescriptive than we have had to date and, understandably, this will make many actuaries and their clients uncomfortable. Nonetheless it must be the duty of the profession to provide strong guidance where too little exists. We cannot expect practicing actuaries to impose their own stronger methods and assumptions in opposition to the desires of their clients.

The current turmoil in public plan funding, while it has many causes and many explanations, will not solve itself. Our reputations are at stake. The profession, via the ASB, must be the bad guy, the adult in the room. We cannot let the politicians dictate actuarial practice while we stand back unwilling to prescribe. Let us step up, protect the actuaries practicing in the public sector, and protect our collective reputations. If the politicians persist, at least we will be on the right side of history. Good risk managers are always the bad guys.