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ASOP No. 27 Revision
Actuarial Standards Board
1850 M Street, NW, Suite 300
Washington, DC 20036

To: Actuarial Standards Board (ASB), Proposed Revision of Actuarial Standard of Practice (ASOP) No. 27

The attached comments were developed through the coordinated efforts of some members of the Conference of Consulting Actuaries' (CCA) Public Plans Community and are being submitted to the ASB by the Steering Committee of the CCA Public Plans Community.   However, these comments do not necessarily reflect the views of the CCA Board, the CCA's other members, or any employers of CCA members, and should not be construed in any way as being endorsed by any of the aforementioned parties.

The attached comments have been developed by actuaries who work primarily with public plans. The CCA Public Plans Steering Committee acknowledges and has incorporated into these comments that differences may exist in assumption setting between private and public sector plans, and that such differences may lend themselves to differing needs when it comes to guidance from the ASB.

The members of the CCA Public Plans Community represent a broad cross section of public-sector actuaries whose extensive experience with public plans provides the framework for our response. The membership includes over 50 leading actuaries whose firms are responsible for cost and liability measurements for the majority of public sector retirement systems. We believe the overall response reflects a substantial consensus among the actuaries who provide valuation and consulting services to public pension plans. We also believe the comments and recommendations made below would improve the final standards by providing a coordinated approach to the pension funding and accounting measures used by state and local governments in a manner consistent with both model actuarial practice and the conceptual goals of financial accounting and reporting.

We are grateful to the ASB for issuing Proposed Revision of Actuarial Standards of Practice (ASOP) No. 27 and inviting public-sector actuaries and others to comment on these important issues. We are also grateful to the ASB and its Pension Committee for their hard work in striving to understand these complicated and interconnected issues.

Paul Angelo, FSA, FCA, MAAA, EA (By Direction)
Chair of the Public Plans Steering Committee on behalf of the
Public Plans Steering Committee

Steering Committee of the Conference of Consulting Actuaries Public Plans Community [1]

Response to Response to ASOP 27 Exposure Draft
April 29, 2011

We are writing on behalf of the Public Plans Steering Committee of the Conference of Consulting Actuaries to respond to the Actuarial Standards Board's request for comments on the recent exposure draft for ASOP No. 27, *Selection of Economic Assumptions for Measuring Pension Obligations*. These comments have been developed by actuaries who work primarily with public plans. The CCA Public Plans Steering Committee acknowledges and has incorporated into these comments that differences may exist in assumption setting between private and public sector plans, and that such differences may lend themselves to differing needs when it comes to guidance from the ASB.

We would like to begin by congratulating the Actuarial Standards Board ("ASB") and its Pension Committee ("ASB-PC") for their balanced approach to these issues. We are pleased that the ASB-PC continues to support using the anticipated investment return as the basis for a discount rate for determining a plan's funding status and requirements. We are also pleased with the ASB-PC's treatment of arithmetic and geometric returns and the discussion regarding how these measures relate to the concept of reasonableness. The remainder of our response addresses the questions posed on page x of the exposure draft, and also discusses several other items we believe are important.

Q1. Is the language in section 3.1 of ASOP No. 27, indicating that assumptions can be based either on the actuary's estimate of future experience or on the actuary's observations of the estimates inherent in financial market data clear? Do you agree that either approach produces a reasonable assumption? If not, what change do you suggest?

> The practice of setting assumptions on "estimates inherent in financial market data" applies narrowly to measures of discount rates based on bond yields or estimates of inflation based on TIPS and other inflation adjusted securities. While these are important economic assumptions, they are special cases of the more general category of economic assumptions used to measure pension obligations. Consequently, we suggest that this type of assumption setting should be referenced in the sections of the ASOP that relate specifically to discount rates and inflation assumptions, rather than in the Overview section 3.1. Placing it in section 3.1 may suggest the distinction applies more broadly to other economic assumptions and consequently give it more weight than is appropriate. At a minimum, if this reference is retained in section 3.1 then it should make clear that only certain economic assumptions can be based on market observations, and cite these two examples.

Q2: Section 3 clarifies that there is no explicit link between the investment return assumption and discount rate. Does this create challenges for any existing actuarial processes? If so, please provide a description of the actuarial practice and how the new standard creates a problem. Is removing the material in section 3.6.2 of the current standard, which addresses the building-block method and the cash flow matching method, appropriate? Are the examples in section 3.7 of ASOP No. 27 sufficient to communicate the various purposes for which actuaries may need to choose a discount rate?

> With regard to eliminating the link between the investment return assumption and the discount rate, we believe that for any payment stream associated with accumulated assets, the most clearly understood and well-defined discount rate is the anticipated investment return on those assets. For that reason, rather than treating these as generally unrelated assumptions, the standard should identify the investment return assumption as one of the canonical bases for setting a discount rate. The standard should then also identify the yields inherent in current financial market conditions as the other general type of basis for setting a discount rate.
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> With regard to removal of the building-block and cash-flow matching methods, we agree that this material is more educational in nature and better addressed in a practice note or other material.

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With regard to the examples in section 3.7, consistent with our comment above, we suggest making clearer that the discount rate examples either anticipate investment earnings or reflect current market measurements. In particular, we suggest:

- Changing the heading for section 3.7(a) to "Contribution and Expense Measurement" on the grounds that both current and proposed accounting standards indicate that the anticipated investment return should be used to determine the pension expense for state and local governmental retirement plans, (as well as for multiemployer plans). Also, the last sentence should refer only to market measurements, since defeasance and settlements are special cases of market measurements.
- Moving section 3.7(b) "Defeasance or Settlement" into section 3.7(c) "Market Measurements" since the discount rates implicit in annuity prices are essentially market measures.
- Renumbering 3.7(c) as 3.7(b) and expanding it to include the following situations where market measurements are appropriate:
    - For determining the present value of benefits on a defeasance or settlement basis, an actuary may use a discount rate implicit in annuity prices or other settlement options;
    - For determining the present value of a payment stream that has been cash-flow matched by a particular portfolio of plan assets, the actuary may use a discount rate based on the expected return or yield implicit in the market price of those assets.
    - The current text describes one type of market based discount rate, using a hypothetical bond portfolio that matches the payment stream being valued. Another example would be the yield curve implicit in current market conditions, without any reference to the benefit stream being valued.
- Renumbering 3.7(d) as 3.7(c) (or moving it back out to the main text) and titling it "Cost Studies" since it describes the more general process of determining the cost, (which is not necessarily a "price"), of plan amendments. The text should then just refer back to sections (a) or (b), depending on whether the purpose of the measurement is to determine a funding/accounting cost or a market-based cost.

Q3: Do you agree that the reasonability standard is an appropriate way to set economic assumptions? If not, why not?

A3: Yes, the standard is clear and guides professional judgment on the part of the actuary.

Q4: Do you agree that the guidance on arithmetic and geometric returns is appropriate? Should the consequences of the use of the geometric or arithmetic returns be disclosed?

A4: Yes, the guidance is appropriate. However, we believe it would be good to further emphasize that the arithmetic return continues to be reasonable and so allowable. Consequently, we suggest rephrasing the last sentence of section 3.6.3(j) to read: "The use of the arithmetic return is reasonable. In addition, the use of the geometric return, either by itself or in combination with the arithmetic return, is reasonable."

We also agree that additional education in this area would be beneficial. Discussion of the consequences of these alternatives might be more appropriate in supplemental educational material.

Q5: Do you agree the guidance in section 3.6.3(d) regarding investment management is appropriate?

Yes.

Q6: Is the guidance in section 3.15.6 on the use of expert advice clear and sufficient.

Yes, we recognize that actuarial advice or the selection of assumptions must reflect the actuary's professional judgment. However, we would broaden the language of 3.15.6 somewhat by substituting the phrase "expert views" for "expert advice." This reflects the fact that information can be obtained from experts without specifically obtaining their advice. We suggest a similar change be made in section 4.1.2.

Q7: Do you agree that it may be appropriate for the actuary to include conservatism in his or her assumptions? Are the disclosure requirements for a conservative assumption sufficient?

> Yes, allowing some degree of conservatism is reasonable depending on the purpose and nature of the measurement. If an adjustment for conservatism is made, we agree it should be disclosed as described in section 4.1.1.

Q8: Do you agree that it may be appropriate to require the actuary to provide rationale for assumptions or change in assumptions? If so, do you agree that the proposed changes represent the appropriate approach?

> Yes, generally we agree actuaries should provide rationale for assumptions or changes in assumptions. However, we are concerned that if such rationale is required in every actuarial communication, it may hinder understanding by providing too much information. We recommend clarifying this section by allowing actuaries to refer back to prior client communications providing the rationale for the assumptions or related changes. We believe this is consistent with ASOP 41 section 3.2 which allows actuaries to communicate actuarial reports using multiple documents.

Other items we would like the ASB to consider include:

Definitions (Sections 2.7 to 2.9)

> As a result of the removal of the building-block material, the definitions in sections 2.7 to 2.9 are no longer applicable and should be removed.

Effective Date (Section 1.4)

> The exposure draft would make revised ASOP 27 effective “for any actuarial work product covered by this standard’s scope produced on or after four months after adoption by the Actuarial Standards Board.” We recommend changing this to be effective for work products “with measurement dates on or after four months after adoption by the Actuarial Standards Board.”

In closing, we again congratulate the ASB’s Pension Committee for their balanced approach to these issues, and are pleased with its continued support for the anticipated investment return as a discount rate. We hope our comments and suggestions will be a help to the Board in further developing actuarial practice.