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COMMENT 19, AUGUST 1, 2008

August 1, 2008

Memo to ASOP No. 27 Request for Comments
Actuarial Standards Board
1100 Seventeenth Street, NW, 7th Fl
Washington, DC 20036-4601

Sent via email on August 1, 2008 to comments@actuary.org

Comments on Actuarial Standard of Practice No. 27 Review

As the administrator and fiduciary of the pension plan for the teachers of California, CalSTRS is pleased that the American Academy of Actuaries' (Academy) Actuarial Standard Board (ASB) is conducting a review of Actuarial Standard of Practice No. 27; Selection of Economic Assumptions for Measuring Pension Obligations (ASOP 27). We hope that this review by the Academy will enhance the information that actuaries provide to its clients.

CalSTRS is responding to the call for comments by the Academy ASB on its review of ASOP 27 and will have comments on the areas that we believe most critically affect this retirement system. The limited nature of these comments should not be interpreted as a lack of interest or opinions in other areas of ASOP 27 that are under review. Rather we feel that the critical effect on our system of the inclusion of so called "financial economics" deserved immediate comment.

The services that actuaries provide are an important component of the proper management any pension plan, especially those that operate in the public sector. As such, and because much of the services that actuaries provide to public sector pension plans is information concerning events that have yet to occur, it is important that actuaries provide information that is clear, accurate, reviewable, and meets the needs of its clients.

The Academy's ASB has posed several questions for discussion, and while we will not address all of these questions individually, we will like to make a few comments overall on the review and address a couple questions specifically.

CalSTRS understands that the debate on the role of "financial economics" in actuarial practice and the selection of economic assumptions in the area of public pension plans is occurring in the actuarial profession. CalSTRS would like to emphasize that public pension plans of local and state governmental entities are much different than pension plans in the private sector that are now subject to the Pension Protection Act of 2006. In our plan, members are guaranteed the benefit structure and the benefit formula for as long as they remain employed with the employer. These benefits, including future accruals can never be taken away or decreased. Under our plan there is no possibility of a plan termination or the sponsoring entity going out of business. In addition, since neither the plan, the sponsor, or the entity can ever be sold, there isn't a "market" or "market conditions" to consider when considering the value of pension liabilities. Measuring liabilities under those types of market conditions is not appropriate. Neither the basis, the assumptions, the conditions or the conclusions of financial economics concerning either funding, measuring or disclosing sponsor pension plan cost apply to public pension plans.

As a result, CalSTRS believes that the ABO measurement based on the accrued benefit concept used in private plans is not useful and may be misleading to primary uses of actuarial information in public plans

We note that there are two questions directing relating to selecting actuarial assumptions that we would like to comment on. Question 1: *Under ASOP No. 27, an actuary selects an economic assumption by developing a "best-estimate range" and selecting a specific point within the best-estimate range. How do actuaries comply with the ASOP? What methodologies do they use to select a specific point within a "best-estimate range"? Is the "best-estimate range" approach the appropriate standard of practice? Does the ASOP inhibit the use of a more appropriate approach to selecting assumptions? Are there any specific changes that should be made to the ASOP to describe appropriate practice more accurately?*

Question 2: *Comments received by the ASB in response to an exposure draft of ASOP No. 4 supported the idea that pension standards should accommodate actuarial practice that incorporates the concepts of financial economics as well as traditional actuarial practice. Does the application of financial economics to the selection of economic assumptions conflict with the guidance in ASOP No. 27, and if so, in what specific ways does it conflict? Should ASOP No. 27 provide specific guidance with respect to financial economics and, if so, what should that guidance be?*

Actuarial assumptions are the actuary's prediction of the future; therefore, the best actuarial assumption is the assumption that most accurately predicts the future. Any new approach or any refinement of actuarial practices should work toward improving the ability of actuaries to choose assumptions that best predict the actual future as it relates to pension plans. Financial economics does not attempt to improve the ability to better predict future events, rather it measures liabilities as if only one set of circumstances exist, even if there is virtually no possibility that those circumstances exist for public plans. As a result, financial economics should not be incorporated in the guidance of ASOP 27. Rather the effect of financial economics should be discussed separately and if deemed necessary, separate guidance should be issued regarding this topic.

Finally any change in actuarial practice that is as potentially as huge as is being discussed demands a through, lengthily review and discussion. One or two forums, with a few papers are not nearly adequate enough to arrive at the proper guidance. Actuaries in pension practice all over the country need to be engaged, financial economics as a discipline need to be studies, and any new practice need to be thoroughly tested.

Sincerely,

Rick Reed
System Actuary