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VIA E-MAIL to: comments@actuary.org August 1, 2008

ASB Comments
American Academy of Actuaries
1100 17th Street, NW, 7th Floor
Washington, DC 20036

To the Members of the Actuarial Standards Board:

I am a consulting actuary whose clients include public sector plans. I am writing to express my views on modifying Actuarial Standard of Practice No. 27 to reflect financial economics and on modifying other statements relevant to the funding of public sector plans.

Financial economics calls for measuring plan liabilities at market, using an appropriate market rate of interest discount. Many proponents of this point of view have opined that the risk-free rate is the appropriate rate, but I disagree, primarily because pension liabilities are not risk free. Liabilities depend on future events, such as pay increases, decisions to retire, and life spans, all of which involve risk. The appropriate rate is the expected compound rate of return, i.e., the geometric mean of expected future returns.

For public sector plan sponsors, it is important that contribution rates be stable from year to year. Budgets must be established well before a fiscal year and cannot be adjusted upwards when interest rates or assets fall. I would suggest that allowing significant asset smoothing is essential. The recent ASOP on this subject gives little useful guidance because it merely requires that the actuarial value should be "reasonable" in the opinion of the actuary. That ASOP does give the impression that there is something wrong with smoothing that needs justification. There is no need to justify anything if the actuary uses market value. I would prefer the ASOP to allow smoothing to as great a degree as appropriate given the priorities of the plan sponsor.

On the other hand, current GASB statements allow amortization periods that are far too long and, even worse, amortization as a "level percentage of payroll." It is reasonable to amortize a deficit over the average future expected working lifetime of current active members, usually 10 to 15 years. Present rules allow up to 30 years and "rolling" periods that start over every year. The "level percentage of payroll" method allows past service contributions that are less than interest on the unfunded liability and amount to negative amortization. It is hard to justify labeling a method as "30-year amortization" when it in fact calls for past service payments that are less than interest every year.

In summary, I'd like ASOPs to require discounting at the expected compound rate of return, to allow lots of smoothing of investment gains and losses, and to require shorter amortization periods and level dollar amortization payments for plan deficits.

Respectfully,

Charles E. Chittenden, FSA, EA, MAAA