August 14, 2014

ASOPs – Public Pension Plan Funding Request for Comments
Actuarial Standards Board
1850 M Street, NW, Suite 300
Washington, DC 20036-4601

Dear Sirs:

The comments below are mine, and do not represent the position of my employer or any of the actuarial organizations to which I belong.

Thank you for allowing me to comment on the issues you will be facing in your upcoming review of the Actuarial Standards of Practice (ASOPs) as they apply to public pension plans. We have seen quite a few recent papers from actuaries or actuarial organizations relating to methods used in funding public pension plans. The guidance is not all the same -- the Blue Ribbon Panel’s guidance differs significantly from that of other organizations in that it advocates the incorporation of financial economics. With the adoption of new accounting standards that will apply only to accounting and not to funding, actuaries have an opportunity to review their funding methods and perhaps develop new ones to enhance the likelihood that the plans they value will meet their funding objectives.

Much of the new guidance specifically addresses details of funding calculations and proposes to narrow the acceptable choices of actuarial methods. It tries to answer, universally, the questions of how long amortization periods should be, whether and to what extent smoothing of market assets should be allowed, and what cost methods are best. In my view, we have too much of this type of guidance and not enough guidance on the more strategic issue of how actuaries should assist their principals in establishing and maintaining funding policies.

1. Public plan funding and associated actuarial valuations are less uniformly regulated than those of private sector pension plans. Actuaries may be asked by their principal to advise on funding levels. Is additional guidance needed, beyond that in recently revised pension ASOPs, regarding appropriate public plan actuarial valuation practice to assist actuaries in performing their work and advising their principals? Why or why not?

Yes, we do need more guidance on the strategic issue of how to establish a plan’s funding policy.
2. If yes to question 1, in what areas is additional guidance needed?

The needed guidance will identify the issues actuaries should discuss with their principals regarding funding policy in view of the present and projected circumstances of the plan and its contributing entities. It will illustrate how actuaries should work with their principals to prioritize their funding policy objectives: namely, funding adequacy, intergenerational equity, and stability of contributions. Representatives of the contributing entities should establish their system’s priorities with input from their actuaries. Actuaries should not set these priorities because they do not make contributions to the plans. In their specialized consulting role, actuaries focus only on the pension plan and do not have to make the difficult decisions regarding whether scarce resources should go to the pension plan or to other equally worthy projects. Actuaries will naturally be biased in favor of generous funding for the pension plans that represent their sole responsibility.

The guidance should not be universal; it should vary depending on the financial condition of the plan and of its contributing entities. If, for example, a plan’s contributing entities can easily increase contributions after periods of poor investment performance to restore the plan to 100% funded status, the need for asset smoothing and other contribution-leveling techniques is reduced or eliminated. Actuaries may need to become aware of the size and variability of revenue streams of the contributing entities in an effort to ensure that plan contribution requirements will fit within these revenue streams.

The guidance should not be a retreat to “well established actuarial practice,” as the California Actuarial Advisory Panel terms its “model” methods. It should encourage the development of new methods where appropriate. After all, traditional funding methods were developed when computing capacity was limited. Actuaries have historically used deterministic methods and limited them to the plan population as of the valuation date at least partly to limit the extent of computational work necessary. With today’s computing capacity, actuaries might be inclined to develop more elaborate methods that model likely future scenarios more robustly, illustrate risks not shown in deterministic models, and give more information and insight to their principals.

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?

No, we should not have a separate valuation standard for public plans. Public plans vary widely in design, size, investment policy, funding condition, commitment to funding, extent of sharing of contribution responsibilities between employers and employees, and outlook for future work force growth. I feel that standardization is likely to be harmful because widely varying circumstances call for widely varying funding policies. Like the “model” funding methods that CAAP has identified, a funding standard may work well for a wide variety of plans, but will work sub-optimally for certain unusual plans. Thus, I prefer incorporation of additional guidance, along the lines suggested above, to a separate public-plan valuation standard.
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?

No. Presently, ASOPs provide very limited guidance on actuarial funding methods, no guidance at all on amortization periods or methods, and guidance on asset smoothing that can be read as permissive or prescriptive. I believe we need less prescriptive guidance on asset smoothing. ASOP 44 essentially says that the actuary must believe that the smoothed value and the fair value will be within a reasonable range of each other most of the time and, when they’re not, they will return to such a range within a reasonable time. Some actuaries take the position that ASOP 44 requires corridors around market value and that the longer the smoothing period, the narrower the corridor must be. That’s a remarkable reading, in my view, but it seems to be widespread. I believe actuaries and the actuarial profession would be better off with guidance on how actuaries can assist plan sponsors in deciding on their funding objectives and how these decisions influence the choices of actuarial methods. We need less prescriptive guidance on the acceptable extent of asset smoothing.

Rather than prescribing “model” methods, ASOPs should address how actuaries should assist their principals in constructing a workable funding policy based on the particulars of the plan and its contributing entities.

5. The ASOPs have provided guidance that has been applicable to all areas of practice in the pension community (for example, private sector, multiemployer, public sector). If you believe that additional guidance is needed for public plan actuarial valuations, should any of that additional guidance also apply to non-public sector plans? Why or why not?

Maybe. There is a very limited need for ASOP guidance on funding pension plans in the private sector because minimum required and maximum deductible contribution amounts are determined by a process that is prescribed -- meticulously, minutely, mind-numbingly prescribed. For the few plans that actually fund above the minimum and want to have a well-defined funding policy to achieve their objectives, it might make sense to apply the guidance I have suggested above to the private sector as well. Church plans and any other plans exempt or partially exempt from Internal Revenue Service funding regulations might also benefit from such guidance.

6. The current definition of an “intended user” of an actuarial communication is “any person who the actuary identifies as able to rely on the actuarial findings” (ASOP No. 41, Actuarial Communications, section 2.7). Should the ASOPs require the actuary for public pension plans to perform additional, significant work (which would be incorporated in the guidance provided in the ASOPs) that is not requested by the principal if that work provides useful information to individuals who are not intended users? Why or why not? If so, should this requirement be extended to all pension practice areas? Why or why not?

First of all, it is imperative that we change the “who” to “whom” in ASOP 41.
No. ASOPs should not require additional work that no principal has requested. We cannot possibly know what information all persons who are not identified as intended users may want, or whether such persons would interpret the information correctly and use it appropriately. If someone who is not an intended user wants additional information, such as the plan’s accrued liability calculated on a market value basis, he should ask the plan sponsor for it or hire an actuary to calculate it for him. When an actuary has to do additional work, someone should have to pay him.

Thank you for this opportunity to address these issues.

Sincerely,

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