29 October 2014

Actuarial Standards Board

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To the Actuarial Standards Board:

I have read all the comment letters on the Public Pension Plan Funding Request for comments as of 20 October 2014, and I believe there are some important practical (and specifically, political) issues to keep in mind.

Primarily: actuaries do not get to decide on the funding of public pension plans. Politicians do.

In addition to actuaries not being able to decide on the amount of funding to be made, public plan actuaries are often given crucial valuation assumptions by the clients. Sometimes these assumptions are written into state law. As well, actuaries do not get to determine pension benefit design, which has sometimes been boosted when the funded status of a plan nudges above 100%.

I agree with Alex Sussman's letter of 24 July 2014[1] that "These are factors beyond an actuary's control, so the proposed ASOP should be crafted so as not to be used as a basis for blaming actuaries for unfortunate events resulting from sponsors' irresponsibilities." Actuaries have found themselves the target of lawsuits, often over decisions other people (specifically politicians) made. Given the troubles many plans are running into, I would not be surprised to see even more lawsuits against actuaries. The politicians will not want to take the blame (unless they're politicians trying to replace the ones who underfunded the plans in the first place.) Actuaries make a juicy target.

So how can we protect actuaries, while also giving stakeholders useful information?

The issues surrounding actuarial valuation of public pensions are contentious, and are unlikely to be settled now through the ASOP process. GASB has made its own decisions regarding balance sheet accounting for public pensions, politicians have made their own laws regarding how pensions should be valued and funded, and it would probably not be helpful for actuaries to promulgate their own, new standards.

Projections to determine the likelihood or timing of future plan failure would also be contentious for similar reasons. The assumptions feeding into the projections would have the same arguments as those used for valuation.

[1] http://www.actuarialstandardsboard.org/comments/ASOPs_and_Public_Pension_Plan_Funding/Comment_2.pdf

That said, I think a retrospective exhibit of the development of the unfunded liability can help, as shown below:

Analysis of Funding **Actuarial Section**

HISTORY OF CHANGE IN UNFUNDED LIABILITY
(Actuarial Funding - Going Concern, Entry Age Normal Method)

Year	Salary Scale	Investment Returns[1]	Employer Contribution[2]	Legislative Amendments
2004	$ (5,428,416)	$ 37,743,856	$ 16,459,733	$ -
2005	(4,928,422)	33,019,546	25,174,375	-
2006	(2,688,379)	8,915,823	22,368,681	-
2007	4,364,583	(9,436,863)	29,263,081	-
2008	1,116,908	86,292,325	26,926,611	-
2009	2,554,058	67,692,897	35,218,424	-
2010	(20,417,059)	49,969,954	46,822,864	-
2011	(25,334,699)	71,034,993	49,402,422	-
2012	(23,145,806)	58,584,984	31,300,739	-
2013	(6,368,436)	(48,963,802)	3,395,524	-
	$ (80,275,668)	$ 354,853,713	$ 286,332,454	$ -

Year	Changes in Actuarial Assumptions	(see assumption reference key 3)	All Other Miscellaneous Experience	Total Increase (Decrease) in Unfunded Liability
2004	$ -		$ (3,535,229)	$ 45,239,944
2005	-		12,490,274	65,755,773
2006	(4,785,773)	(m, r, p, s, n)	8,949,341	32,759,693
2007	-		(1,007,539)	23,183,262
2008	(22,899,666)	(rb)	10,718,411	102,154,589
2009	-		15,455,286	120,920,665
2010	39,769,482	(m, r, t)	7,577,298	123,722,539
2011	-		23,734,658	118,837,374
2012	7,171,009	(d)	(18,064,759)	55,846,167
2013			(1,423,368)	(53,360,082)
	$ 19,255,052		$ 54,894,373	$ 635,059,924

1 Represents investment income deficiency (excess) over expected returns.
2 Represents employer contributions deficiency (excess) from normal cost plus interest.
3 Key to changes in assumptions:

r = retirement rates
m = mortality
n = not married
p = pension for survivors

d=disability assumption
s = salary
rb = reciprocal benefits
t = termination rates

The above exhibit can be found on page 89 of the 2013 CAFR of the Metropolitan Water Reclamation District Retirement Fund[2], as part of the actuarial report as prepared by Jason L. Franken, FSA, EA, MAAA of Foster & Foster.

I have looked at a variety of official reports of the development of funded ratios, growth in the unfunded liability, percentage of ARC actually contributed, and other types of measurements of fundedness. However, other than giving an idea things are or are not going well, in many cases it's difficult to make a decision based on the exhibits shown.

When one sees that 80% of the ARC was actually contributed, one wonders how bad that ultimately is. If one sees asset losses over one year, what does it mean in the long run? One might have seen a particular average portfolio return over time, but cash flows in and out of the plan, so average returns may distort thinking about what a good assumption about rate of return would be.

The historical exhibit as above helps stakeholders see how changes develop over time and where the largest problems are. This is especially the case when actuaries are trying to influence decision-makers in terms of increasing funding or changing assumptions being used. The arguments about contributions needing to be made or discount rates needing to be changed become less theoretical when one sees how these decisions have actually played out over history.

It takes a good deal of time for such deviations to reveal themselves in a consistent way, so I think that it may be useful to require a development of the unfunded liability over a long time (perhaps not proscribing the time period, but it seems to me at least a decade would be called for.) In addition, in order to understand the magnitude of the issue, such a historical development table should include balance sheet items such as the total liability amount and unfunded liability amount, so one can make percentage comparisons.

This recommendation may be better promulgated through a practice note, as opposed to an ASOP. The goal I seek is to protect the actuary from blame with respect to underfunding, while also giving decision-makers and third parties an understanding as to the development of the health of the pension plan over time and causes for its deterioration.

Thank you for your time and consideration,

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[2] http://www.mwrdrf.org/media/1048/cafr2013_v1.pdf