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

Re: Request for Comments – ASOPs and Public Plan Funding and Accounting

To the Actuarial Standards Board (ASB):

On behalf of Segal Consulting, attached are comments as requested in your July 2014 communication entitled “Request for Comments – ASOPs and Public Pension Plan Funding and Accounting.” We appreciate the opportunity to comment on this important topic.

The request for comments is described as “…concerning the application of the Actuarial Standards of Practice (ASOPs) in regards to actuarial valuations and other analyses used for determining public pension and other postemployment plan funding and accounting…” Segal believes that any review of the ASOPs as they apply to retiree health care plans should be addressed separately from the review of the ASOPs as they apply to pension plans. The mechanisms for funding and disclosure of these plans are very different and merit their own discussions. Our comments here are limited to the application of ASOPs to pension plans.

We have individually addressed each of the numbered questions in your memo below.

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 the recently revised pension ASOPs, regarding appropriate public plan actuarial valuation practice to assist actuaries in performing their work and advising their principal? Why or why not?

Segal believes that, for the most part, current Actuarial Standards of Practice provide enough guidance for actuaries to assist clients in establishing funding policies. These ASOPs allow for a wide range of practices and are flexible enough to accommodate a variety of circumstances. However, it may be useful for the ASB to identify certain practices that would require additional disclosures.

We do not propose that these practices be prohibited by a new ASOP; only that additional disclosures be required when these practices are used. These disclosures would be useful in making sure that actuaries provide information that encourages the adoption of transparent and understandable funding policies.

2. If yes to question 1, in what areas is additional guidance needed?

One area of concern is the use of an amortization method that results in “negative amortization,” particularly when used with an open or “rolling” amortization period (where the amortization period is reset each year). Negative amortization occurs when the payment toward the UAAL does not fully cover interest (or any principal amount) and, as a result, the UAAL increases from one valuation to the next. The amortization methods that result in negative amortization combine a relatively long amortization period with a level percentage of payroll payment (*i.e.*, the payments increase from year to year based upon a payroll growth assumption). When combined with a “rolling” amortization period, this can result in a situation where the UAAL never decreases in dollar amount.

Special quantitative disclosures should be required in these situations so that the effect and duration of any negative amortization are illustrated. Required disclosures could include the number of years until the negative amortization is eliminated (which would be infinite for rolling, negative amortization), or a projection of the UAAL over the anticipated amortization period (or over some specified period for rolling amortization).

A second area of concern is the information disclosed for “fixed rate” plans. A fixed rate plan is one where the employer contribution is set by statute and does not vary from year to year. For these types of plans, the implicit amortization period should be disclosed annually. The implicit amortization period is the number of years, as of the valuation date, over which the UAAL is expected to be amortized based upon the statutory contributions and assuming all assumptions are realized. If the implicit amortization period results in negative amortization (*i.e.*, the fixed contribution does not cover interest on the current UAAL), then the disclosures described in the paragraph above should be made.

A third area of concern is the use of an actuarial cost method under which the normal cost assigned to a given individual is not based upon that individual’s benefits – for example, when the benefit formula for participants in a new tier is used to determine the normal cost for participants in prior tiers. Required disclosures may include a description of how the use of this actuarial cost method affects the plan’s normal cost, UAAL, and recommended contribution. For fixed rate plans, the disclosures may also include how the use of this actuarial cost method affects the implicit amortization period.

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?

Segal believes that the current framework of ASOPs is adequate in providing actuarial valuation standards that apply to public plans, and that any additional guidance should be incorporated within the current standards. The current standards provide guidance for all elements of a cost or contribution allocation procedure (*i.e*., actuarial cost methods, asset valuation methods and amortization methods) as well as the actuarial assumptions. For that reason, any additional guidance should be included within the framework of the current ASOPs. If a new, separate actuarial valuation ASOP were adopted that incorporated any new guidance along with existing guidance, the result could be less effective guidance overall due to overlap, inconsistencies, and the need for cross-references among the new and the current ASOPs. In addition, any future modifications to the current ASOPs would also need to maintain consistency and cross-references to the new actuarial valuation ASOP.

As further discussed in our response to question 5, Segal believes the same standards should apply to all actuaries performing similar work. If there is a specific area of new guidance that is not related to one of the current standards, a separate standard could be created for that topic area. As an example, we know that the ASB is working on a standard related to pension plan risks and this standard should apply to all types of plans.

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?

Segal believes that the ASOPs should remain principles based, but some areas, such as the specification of required disclosures, could be more prescriptive as described in our response to question 2.

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 nonpublic sector plans? Why or why not?

Segal believes that the principles in the ASOPs should apply to all actuaries who are providing a specific type of actuarial service (*e.g.,* pension plan actuarial valuations), regardless of the type of plan served. If different standards apply to different actuaries depending on the type of plan they are serving, the standards would not be requiring the same level of practice from all actuaries, which would reduce the consistency and reliability of the work governed by the standards.

As a practical matter, some types of retirement plans (*e.g.,* private sector and multiemployer) are more heavily regulated than others, but that does not preclude the standards from applying to actuaries who serve these types of plans. Other plans such as public sector plans, church plans and nonqualified plans are not as heavily or consistently regulated and actuaries who serve those plans should be held to the same standards. Because of other regulation, some provisions of the standards may not have the same impact on all types of plans. Nevertheless, the principles and resulting guidance of the standards should be applicable to all actuaries regardless of the type of plan they are serving.

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?

Segal recognizes that public sector actuaries provide information that is useful to a number of stakeholders. In situations where an additional request from a non-principal is a natural byproduct of the work performed for a public sector client, the work should be provided where deemed practicable by the principal. However, we note that the ASOPs govern the quality of actuarial work, not the "usefulness," which may be difficult for the actuary to determine objectively. Furthermore, the Academy Code of Professional Conduct already requires that actuarial communications be clear and appropriate for the situation, and that the actuary take steps to ensure that actuarial services are not used to mislead other parties.

A requirement that public pension plan actuaries provide "useful information" to individuals who are not intended users is not feasible in practice. Additional significant work provided to non-principals may have to be performed outside the scope of existing client agreements. Also, the ASOP would have to carefully define what requests meet the "useful information" standard. This would vary from plan to plan and stakeholder to stakeholder.

Once again, we greatly appreciate the opportunity to comment on this important topic. If you have any questions or require any clarification on our comments, please do not hesitate to contact me.

Sincerely yours,

Kim Nicholl

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