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November 13, 2014

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

To: Actuarial Standards Board (ASB), Request for Comments – ASOPs and Public Pension Plan Funding and Accounting

These comments are in response to the request for written comments on the “ASOPs and Public Pension Plan Funding and Accounting.” The following comments were developed through the coordinated efforts of members of the Conference of Consulting Actuaries’ (CCA) Public Plans Community and are being submitted to the ASB by the Steering Committee of the CCA Public Plans Community. However, these comments do not necessarily reflect the views of the CCA Board, the CCA’s other members, or any employers of CCA members, and should not be construed as being endorsed by any of the aforementioned parties.

The CCA Public Plans Community (PPC) represents a broad cross section of public-sector actuaries whose extensive experience with public plans provides the framework for our response. The PPC includes over 50 leading actuaries whose firms are responsible for the actuarial services provided to the majority of public-sector retirement systems. Our membership includes a diversity of opinions and perspectives on public pension plan valuation issues, such that not all of our community, necessarily, subscribe fully to all of the comments presented here. Nonetheless we believe the overall response reflects a substantial consensus among the actuaries who provide valuation and consulting services to public pension plans.

We are grateful to the ASB for exploring ASOPs on Public Pension Plan Funding and Accounting and inviting public-sector actuaries and others to comment on these important issues. We are also grateful to the ASB and Pension Committee for their hard work in striving to understand these complicated and interconnected issues.

*Paul Angelo, FSA, FCA, MAAA, EA (By Direction)*  
Chair of the Public Plans Steering Committee on behalf of the  
Public Plans Steering Committee

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**Public Plan Steering Committee**

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## Steering Committee of the Conference of Consulting Actuaries' Public Plans Community<sup>1</sup>

### Response to the Actuarial Standards Board (ASB),

#### Request for Comments – ASOPs and Public Pension Plan Funding and Accounting

**Question 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?**

To the extent that the problems faced by public-sector retirement plans may be traced to the absence of regulation, additional guidance in the form of ASOPs is a questionable substitute for such regulation. As has often been noted, many public-sector retirement plans that are underfunded find themselves in that situation because their sponsors have disregarded the advice of their actuaries, and it is not clear that any new or rewritten ASOP could have prevented such developments.

At the same time, there are certain kinds of additional guidance that could, if properly crafted, prove helpful to public-sector retirement systems and their actuaries:

1. To the extent that the range of permissible practice under current ASOPs has been construed to extend to extremes that have proven harmful in practice, that range could be narrowed to exclude such extremes.
2. Targeted required disclosures could provide an actuary serving a public-sector plan (or other plan whose funding is exempt from federal regulation) with an opportunity that might not otherwise arise to call attention to sponsor choices that are at odds with actuarial recommendations or are otherwise inappropriate.

As a preface to the remaining responses, we note that it was sometimes difficult to answer one of the remaining questions without drifting in another. However, some overlap might be useful to highlight the key points. In particular, we do not believe that there is a need either for a separate standard or for separate guidance within the current standards that specifically addresses only public-sector pension actuarial practice, for the following reasons:

1. ASOPs are supposed to be principles-based and not situation-based, and actuarial principles apply to all types of pension plans (also see questions 4 and 5).
2. There are other categories of pension plans, such as church plans and corporate non-qualified plans, that are also "less uniformly regulated" than plans whose funding is subject to the requirements of ERISA and related statutes, and presumably any guidance offered to public-sector plans due to their exemption from such requirements would be applicable to these plans as well (also see question 3).

### **Question 2: If yes to question 1, in what areas is additional guidance needed?**

As discussed in ASOP 1, the guidance in the ASOPs generally appears in two key sections of each ASOP:

- Section Three: Provides an analysis of issues and recommended practice
- Section Four: Addresses communication and disclosure

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Your question asks about additional “guidance.” Guidance is sometimes thought of as just applying to section three of the ASOPs. Our response below covers guidance as found in both sections three and four.

Additional guidance would be helpful in both calculation issues, i.e., methods and assumptions (ASOP sections 3) and disclosure requirements (ASOP sections 4).

We believe current ASOPs provide significant guidance to pension actuaries and any calculation guidance should be limited to those few areas where it is clear current ASOPs do not provide sufficient guidance and, consequently, specific guidance as to where the out-of-bounds markers lie would be valuable. We offer the following calculation practices as meeting these criteria:

1. Rolling amortization with permanent negative amortization. This practice, even if all assumptions are met, results in a perpetually increasing unfunded liability (even if the funded ratio may increase).
2. “Ultimate entry age” cost method, by which we mean the practice of basing an individual’s normal cost not on that individual’s benefit level, but on a new benefit level applicable only to future hires. This method shifts costs between the normal cost and the actuarial liability even though there has been no change in benefits for current members.<sup>2</sup>
3. Phasing in the liability impact of method and assumption changes (by phasing in the assumption change itself) rather than phasing in the impact of those changes on the actuarially determined contribution. This method results in the current unfunded liability not reflecting the full impact of method and assumption changes.

Disclosure guidance is currently somewhat less specific than calculation guidance, indicating that the ASB may want to provide some broad disclosure guidance that would provide the intended users of pension actuarial reports information that is currently not always provided. However, we caution the ASB that, because pension plans vary significantly in benefits provided, plan maturity, size and many other factors, significant discretion should continue to be available to pension actuaries. The primary area where we believe additional disclosure guidance could be appropriate is with respect to contribution policy. For example:

- Impact when a plan sponsor does not fund or has historically not funded the actuarially determined contribution.
- Existence of negative and/or rolling amortization with impact on unfunded liability if assumptions are met.
- Additional discussion of gain sharing issues. The ASB should note there is a wide variety of gain sharing plan designs and this variance will always require some professional judgment as to what is appropriate to disclose.
- Relationship between contribution policy and intergenerational equity<sup>3</sup>.

We also believe that there needs to be more discussion of risk measures. The Risk ASOP that is already under development is the logical place to set forth such standards.

**Question 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?**

Any additional guidance regarding appropriate public plan actuarial valuation practice should be developed within the

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<sup>2</sup> See the “Actuarial Cost Methods” section of the recent CCA PPC white paper “Actuarial Funding Policies and Practices for Public Pension Plans” for a detailed discussion of different variations of the Entry Age cost method.

<sup>3</sup> As noted in the recent GAO study “Pension Plan Valuation: Views on Using Multiple Measures to Offer a More Complete Financial Picture” the concept of intergenerational equity is something experts agree on in general but something that they disagree on as to what this means in practice. The “General Policy Objectives” section of the recent CCA PPC white paper “Actuarial Funding Policies and Practices for Public Pension Plans” has a helpful discussion on balancing different types of interperiod and intergenerational equity

existing ASOP framework, and likely within the existing ASOPs<sup>4</sup> providing coordinated guidance for measuring pension and retiree group benefit obligations. We recognize that as a practical matter some guidance might apply primarily to public plans since overriding prescriptive methods might apply to some *non-public* sector plans.

There are multiple reasons why any additional guidance should be incorporated within the existing ASOPs rather than taking the form of a separate public plan actuarial valuation standard, but the most fundamental can be found in Section 3.1.4 of ASOP 1: “ASOPs provide the actuary with an analytical framework for exercising professional judgment.” As such, any additional guidance that is developed should be developed based on sound actuarial concepts and general principles rather than be prescriptive to subsets of plans at a point in time.

Where possible, any new guidance should be incorporated within the existing coordinated guidance for measuring pensions to enhance the consistency and usability of the guidance. However, it may be decided that some area of additional guidance would best be provided through a new ASOP. If this is decided, it is important that steps are taken to ensure that:

1. Any proposed new ASOP guidance is incorporated into any existing ASOPs that address that subject matter (e.g., ASOP 4 for contribution allocation procedures, ASOP 44 for asset valuation methods and ASOPs 27 and 35 for actuarial assumptions).
2. Any new standard applies to any actuary making a recommendation related to the subject matter of the proposed new ASOP (e.g., the new ASOP on risk).

Additional benefits of developing any guidance within the existing ASOPs rather than developing a separate public plan actuarial valuation standard include:

- Guidance developed would also be available to actuaries performing work on other types of plans, such as church and multiemployer plans, where such professional guidance would be of value,
- Existing guidance already covers a case in which there are regulatory changes in another practice area that reintroduces the need for professional judgment to be used,
- It is consistent with the intentional effort to minimize the need for cross-references throughout the ASOPs as has been explicitly noted in the ASB Procedures Manual (ASB Doc. No. 117 revised September 2009 III. D.).

In summation, any new guidance developed should apply to any actuary performing applicable work and should continue to be developed in the coordinated approach currently utilized in reviewing and revising the pension plan-related standards.

**Question 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?**

Public plans are less uniformly regulated than ERISA plans in terms of funding rules. The disclosure rules for public plan valuations come from both ASB and GASB and are uniform for all public plans. Lack of uniformity in funding can create a need for actuaries to be able to say when something is outside the range of reasonable actuarial practice. In these situations, it might be helpful if the ASOPs established some boundaries that actuaries could use to encourage better funding practices. Neither the ASOPs nor actuaries have the authority to require specific funding practices.

In the case of funding, it is better if any prescriptive impact follows from the ASOP principles, thereby allowing the ASOPs to let specific practices vary within those principles. For example, a prescription against rolling negative amortization of the entire unfunded liability could flow from a principle that could be stated in an ASOP that unfunded liability must eventually decrease. Similarly, a prescription against the Ultimate Entry Age cost method might derive from the principle that the Normal Cost of each member should be based on that member's career and future benefit.

One of the real strengths of the existing principles-based approach to guidance is that it allows reflection of different circumstances and objectives, such as the characteristics and circumstances of the plan or plan sponsor and explicitly recognizes that there often is not one universal answer. ASOPs must allow for professional judgment, or otherwise

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<sup>4</sup> We believe that draft Risk ASOP will be an important new ASOP, but like all ASOPs, should apply to all plans. Having ASOPs by “issue” (e.g. communications, asset smoothing, risk, health care factors) makes sense but not by type of plan sponsor.

potentially impair the quality of services. For example, use of Entry Age Normal actuarial cost method for funding is generally considered a best practice. However, for variable annuity plans a Unit Credit method might make more sense.

In the case of disclosure, it is possible for rules (and not just principles) to be more prescriptive. However, the burden (expense) of creating longer reports (that few read) needs to be considered.

One reason it is difficult to be too specific about defining universally “best” practices is that there are competing objectives. The value of the CCA White Paper on public plan funding is as much a discussion of policy goals and considerations as it is in the actual guidelines. Not everyone will have the same risk appetite or situation. This favors the development of principles over uniform rules.

We will separately address under Question 5 whether any rules should only apply to public plans.

**Question 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?**

We believe that if the guidance points to sound actuarial practice, it remains sound independent of the type of sponsor or the tax-qualified status of the plan. Actuarial calculations related to pension plans are to provide guidance to the plan sponsor so that plan’s cash needs in the future are met by making contributions and investing those funds before benefits are paid. Private sector plans may have been subject to some constraints on the funding in order to meet tax qualification requirements (for qualified or non-qualified plans), just as public sector plans may have constraints imposed by state laws. In any case, the actuarial analysis will compare balancing of the needs and resources in light of governing constraints. For many private sector plans, the binding laws may make any new ASOP guidance of limited practical impact. However, even for those plans, guidance from the ASOPs would be valuable in the event the regulatory structure changes in the future.

For these reasons we believe that any new or amended guidance should apply to all aspects of retirement practice.

**Question 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?**

The question opens two related topics:

1. whether stakeholders are allowed access to the actuary; and
2. if the ASB is intending to anticipate common questions that might be asked (e.g. additional risk disclosures).

Our response focuses on the former. We will comment on specific proposals as they are proposed. However, we believe our comments to item (1) are still informative as to the relationship among the actuary, the principal, intended users and other interested parties.

No is our answer to the first question posed by the ASB in Question 6. The present approach for providing additional work should not be changed. Only the principal has the authority to define the purpose of any actuarial work, and so only the principal should determine when it is appropriate to provide actuarial information to individuals who are not intended users.

There are already a variety of mechanisms in place for stakeholders to request from the principal (usually a politically constituted governing board) additional information that they might find useful. If the governing board decides the additional information is not needed or is inconsistent with the purpose of the actuary’s work, the actuarial standards should not overrule that determination.

There are situations in which allowing non-intended users to demand additional information would be untenable. For example, many public plans provide benefits that are subject to collective bargaining. The suggested change in the ASOPs could allow each side in collective bargaining to request additional information that may or may not be made available to all bargaining parties. An even more complicated situation could arise if there are multiple actuaries involved (potentially there could be three actuaries working for the employer, union and pension Board). Under the suggested change, any of these parties could potentially request information from any of the other parties' actuaries, creating a possible web of conflicts of interest.

Another consideration is that if the actuary is required to provide actuarial information to an individual and this work has not been approved by the principal, then the actuary may not be paid for this work by either the principal or the individual requesting the work. If this individual pays the actuary for the work, then the individual becomes a client of the actuary. This could result in a conflict of interest for the actuary because the pension plan board or administrator would be one client, and his other client would be the individual who asks for and pays for the additional actuarial information.

Another instance in which the proposed change would be unmanageable, would be a merger/acquisition transaction in which one side of the negotiation could demand information developed on a confidential basis for the other side.

Yes is the answer to the last question posed by the ASB in Question 6. If the ASB decides that the present approach should be changed to allow individuals who are not intended users to demand specific information from the actuary without going through the principal, then this requirement should be extended to actuaries in all other pension related areas; e.g., private pension plans, multiple employer pension plans, church pension plans, and the PBGC.

This is another example where the ASB should continue its present practice of treating all pension practice areas the same. If they decide that additional principles need to be established for public pension plans, then the ASB should require actuaries of private pension plans, church pension plans, multiemployer pension plans, and nonqualified plans to adhere to the same principles.