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November 15, 2014
Actuarial Standards Board
1850 M Street, NW, Suite 300
Washington, D.C. 20036-4601

To the Actuarial Standards Board:

I appreciate the decision by the Actuarial Standards Board (ASB) to review the Actuarial Standards of Practice (ASOPs) in light of events during the past decade that have illuminated and identified the consequences of downside risk on pension plan funding. Given the Laura and John Arnold Foundation's (LJAF) commitment to the sustainability of public pensions, I am pleased to respond to this request for comments.

LJAF is dedicated to supporting evidence-based decision making, sustainable public finance, transparency and data-sharing, and the efficiency and efficacy of the public sector. In an effort to guarantee public workers' retirement security and improve fiscal sustainability, the Foundation is committed to assisting state and local governments with the challenges associated with their public retirement systems. In the past four years, I personally have delivered expert testimony on pension issues in a number of jurisdictions, spoken at many gatherings of pension trustees and actuaries, including the annual Conference of Consulting Actuaries meeting, and have used actuarial reports and actuarial information to provide analyses of pension benefit and cost dynamics to more than 50 jurisdictions across the country.

Though it has been five years since the official end of the Great Recession, state and local governments across the nation continue to face considerable financial stress, and funding policies of public retirement systems in most jurisdictions are not sustainable. Despite recent reform efforts, most pension systems are more sensitive than ever to economic, demographic, and financial shocks. Even the slightest shock will have serious repercussions for plan solvency. This precarious situation must receive sustained attention from the actuarial profession.

The profession has already engaged in many highly relevant discussions involving financial and accounting matters for pension plans, and I recognize the value of this work. Your questions on actuarial standards, to which my responses are recorded below, should serve to further evolve the actuarial profession to support governments and their pension systems. To summarize my comments, the standards should:

- Be more prescriptive;
- Include a discussion of risk and uncertainty, and;
- Have disclosures that are forward looking and useful to a broader audience.

Sincerely,

Josh McGee, Ph.D., Vice President of Public Accountability
Laura and John Arnold Foundation

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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 advice 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?*

   Additional guidance is essential. Although there are many factors that have led to the large, unfunded pension obligations facing many systems across the nation, the failure to make sufficient contributions tops the list. In practice, too many jurisdictions ignore the advice of actuaries. As such, political and budgetary pressures easily override actuarial advice on target funding levels and appropriate contribution rates. However, this dynamic can be mitigated by a greater degree of prescription in the standards. Specifically, the standards can bring focus to the profession's expertise in developing and communicating solutions to the pension challenges. They can empower actuaries to improve the degree of prudence in funding recommendations, and they can institute a framework whereby disclosures and reports inform key stakeholders, policymakers, public workers, and taxpayers on the repercussions of risk and uncertainty for pension plans.

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

   I regularly review actuarial reports for major state and local public retirement systems in the United States in my academic research and my technical support provided to governments. As is evident in these reports, there are several ways in which public pension disclosure and reporting can be improved.

   Actuarial disclosures are too heavily focused on compliance and historical analysis, and despite the fact that actuaries themselves are trained in measuring risk and uncertainty, a discussion on these important topics has been absent in nearly every report that I have reviewed. While measuring risk would involve a more rigorous analysis than current efforts to report the liability, normal cost, and amortization schedules, the value of doing so would exceed the cost. Such analysis would directly inform the decisions made by plan executives, the plan board, and policymakers.

   Reports should also look to the future rather than only to the past. Clearly expressing assets, liabilities, and funding as a function of assumptions and a range around those assumptions will allow stakeholders to better understand the trade-offs of risk. Reporting should also be timely and should be written not only for plan administrators and trustees but also for plan members and employers.

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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?*

   I strongly believe that there should be a separate actuarial valuation standard for public pensions for two key reasons.

   First, the regulatory environment and political economy of public pension systems vastly differs from that of private pension systems, meaning that assumptions, methods, disclosures, and governance greatly differ between public and private pensions.

   Second, the risks to public pensions are borne by a more varied group of stakeholders. Any risk to the pension system is risk that is spread to the workers, taxpayers, and the local economy. Failure to properly manage a public retirement system can have serious consequences for other public services including education, safety, and infrastructure. Thus, the risk for a public pension system is contagious and potentially systemic, whereas risk for a private pension system is fairly isolated to that particular institution and its workforce.

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?*

   Indeed, the ASOPs related to public plan actuarial valuations should be more prescriptive for the reasons mentioned in my previous response, and there are a number of areas in which a more prescriptive approach could greatly assist in plan governance. These include guidance on: (1) selecting actuarial cost methods and amortization methods for funding calculations, (2) instituting regular examinations of assumptions such as the investment rate of return and inflation, (3) setting modeling assumptions in which a plan provision has optionality (i.e. cost of living adjustments based on investment returns, inflation, or other measures of market condition), and (4) reflecting mortality improvement projection scales.

   I'd like to see this new guidance help expand the discussion of pension funding and risk even further. The questions that I find most relevant to stakeholders are (1) "What is the probability that the annual contributions from the plan sponsor will be sufficient to fully fund benefit promises?" and (2) "Should plan assumptions, and thus contributions, be more conservative to better ensure benefits are fully funded?" I'd like to see the standards create a framework where actuaries have a common understanding of how to evaluate and communicate the answer to these questions, and incorporate this type of analysis into the selection of the values for key plan assumptions that set employers' annual contributions.

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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?*

   My area of focus at this time is public pension plans, and so I hesitate to make judgments or assertions for private plans. But, whether or not specific guidance applies to both public and private pension plans will largely depend on the characteristics of those plans and their fundamental differences. While the objective of the guidance is largely the same for public pension plans and private pension plans, the method in which that objective is achieved may vary due to these underlying differences. The guidance will be more relevant and effective to the extent that it is tailored to account for these factors.

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 actual group of users is likely broader than the current set of "intended users," and given that several public pension systems provide actuarial reports and other useful documents on their website, it is apparent that these systems aim to inform a wider audience. However, to be even more transparent, actuarial reports should be expanded to address topics of relevance to this larger group, which includes: (1) budget officers interested in understanding short-term contribution trends, (2) taxpayers and other stakeholders who wish to understand the pension plan's long-term cost under alternative economic, demographic, and financial conditions, (3) members questioning the security of their retirement benefits, and (4) groups inquiring about the risk surrounding plan assumptions.

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