To the Actuarial Standards Board (ASB):

The Pension Finance Task Force (PFTF) is jointly sponsored by the Society of Actuaries and the American Academy of Actuaries. On behalf of the PFTF, I submit these comments which are intended as PFTF views only and not those of our sponsoring organizations.

Aspects of actuarial practice related to public plans are appropriate areas of ASB attention. In the interest of brevity, we focus on public plan disclosure and related assumptions, and we recommend that the ASB require disclosure of:

1. Solvency liability[1] and normal cost based on:
   - Discounting at a default-free discount curve and
   - The unit credit actuarial cost method.
2. The projected cash flows forming the basis of the solvency liability. This is the most critical element of our recommendation, because with this information and other available data an analyst could derive almost all of the other suggested items.
3. Solvency liability deficit and funded percentage, both calculated with reference to the market (not a smoothed) value of assets.

Solvency liability is used in other countries (e.g., Canada and the Netherlands), and is a key metric for insurance companies. It is not necessarily the market liability[2], nor is it a proxy for insurance company annuity pricing.

The ASB should recognize that participants, taxpayers, bond holders, and users of government services also rely on the work of public plan actuaries. Those who hire and/or retain the actuary are merely agents acting on behalf of these economic principals.

Rationale for recommendations:

1. The economic theory underlying solvency liability applies even to long-term non-traded financial instruments, like pension liabilities. Using an assumed return assumption to discount liabilities that includes, e.g., an equity risk premium, when liabilities themselves do not have equity risk, results in understated liabilities. It creates economically unjustifiable incentives to increase investment risk, because doing so reduces funding and reporting liability measures.
2. As a market-based measure of the value that principals have at stake, solvency liability disclosure will likely lead to better decisions about benefit levels, funding, and investing. For example, a plan that is described as 100% funded under current practice may be only 60% funded on a solvency basis. Such knowledge could prevent an ultimately unaffordable benefit increase from being adopted and might make the sponsor less likely to skip contributions.
3. Solvency liability funded status may be the best indicator of how well the public finance goal of intergenerational equity is being met.

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[1] Defined in the *Pension Actuary's Guide to Financial Economics* (the "Guide") as "…the market value of a defeasance portfolio comprised of risk-free traded securities (e.g., U.S. Treasuries)." http://actuary.org/pdf/pension/finguide.pdf

[2] Defined in the *Guide* as: "… the market value of a reference portfolio comprised of traded securities. A reference portfolio matches the benefit stream in amount, timing and probability of payment." It includes default risk, and is usually lower than solvency liability. It approaches solvency liability as plans approach full funding and/or sponsor financial health improves.

4. Solvency liability is the least subjective liability measure. Measurement differences among actuarial firms will be minimal, thereby allowing for comparisons across plans. Universal disclosure would have warned of shortfalls that have instead been surprises in major systems such as those experienced in the City of Detroit bankruptcy.
5. Reputational risk for actuaries among academics and think tanks, other finance professionals, the media, and the general public would be reduced.
   - Public plan practice is increasingly subject to criticism from the media and others. Examples are easy to find:
     - A May 25 article in *The New York Times* stated that "Warnings were ignored, though, and shortfalls accumulated. It was easy for officials to let that happen because actuarial calculations can understate the true cost of a pension plan …"[3]
     - Former New York City mayor Michael Bloomberg, widely respected in financial circles, said, in reference to NYC pensions: "The actuary is … going to lower the … [discount] rate from an absolutely hysterical, laughable 8 percent to a totally indefensible 7 or 7.5 percent …"[4]
     - An opinion piece in *The Economist,* discussing a paper issued by the American Enterprise Institute, stated that, in using an assumed return assumption for valuing public pension plans, "America is behind the times."[5]
   - Some non-actuary defenders of current practice point to ASOPs to justify practices that inconsistent with well-established finance theory and practice.
6. There are few external controls on public plan practice, which increases the need for greater self-regulation in this area.
   - In most instances, there is nothing comparable to ERISA[6] minimum funding requirements.
   - The requirements of Government Accounting Standards Board (GASB) Statements 67 and 68 are not adequate to meet the goals of accountability, decision usefulness and assessment of inter-period equity.
7. Without ASOPs to accomplish universal disclosure of solvency liabilities, the decision to do so may be controlled by the plans without considering obligations to other principals.

While the PFTF conceptually supports disclosure of solvency liability in other contexts also, the need for ASOP regulation is less urgent where external controls (e.g., ERISA and GAAP[7]) exist. Further, the economic principals in a public plan include taxpayers, on whose behalf the profession should assume a public interest role.

Beneficiaries of our recommended disclosures would include:

- Plan participants;

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[3] Monica Davis and Mary Williams Walsh, "Pensions and Politics Fuel Crisis in Illinois," *The New York Times*, 25 May 2015.

[4] Mary Williams Walsh and Danny Hakim, "Public Pensions Faulted for Bets on Rosy Returns," *The New York Times*, 27 May 2012.

[5] http://www.economist.com/blogs/buttonwood/2013/05/pensions-0

[6] The Employee Retirement Income Security Act of 1974 (ERISA)

[7] Generally Accepted Accounting Principles

- The public, as taxpayers and users of government services;
- Elected officials and candidates for office;
- Academics who study public pension plans, and those informed by them;
- Actuaries serving public plans; and
- The actuarial profession as a whole, as reputational risk is reduced.

Moving beyond disclosure, the PFTF also believes that determining the amounts and timing of additional contributions to close funding deficits is a public policy issue, not an actuarial issue. The ASB may wish to take this perspective into account when setting standards on communications.

Thank you for considering our recommendations.