Organization: Segal Consulting

Title: National Public Sector Retirement Practice Leader

Comments: On behalf of Segal Consulting, attached is our input as requested in your May 2015 communication entitled “Actuarial Standards Board Hearing on Public Pension Issues.” We appreciate the opportunity to provide input on the topic areas included in the communication.

We have individually addressed each of the numbered questions in your communication. Note that, where germane, these comments reflect our November 12, 2014 response to the ASB’s earlier request for Comment on ASOPs and Public Plan Funding and Accounting.

1. Contribution/Cost Allocation Procedures

Segal believes that, for the most part, current Actuarial Standards of Practice (ASOPs) 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. The specific ASOPs that cover funding policies and assumptions include ASOPs 4, 27, 35, and 44.
In addition, actuarial organizations such as the Conference of Consulting Actuaries and the American Academy of Actuaries have been involved in developing model funding objectives and policies for public sector plans.

However, we believe the ASB should require additional disclosures for certain amortization practices described in item 2 below. In addition, we recommend the following:

- Ultimate” entry age cost method – Under this method, 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. For plans using this method, required disclosures would show the plan’s normal cost, UAAL and actuarially determined contribution under an entry age cost method that bases each member’s normal cost on that member’s benefits. For fixed rate plans using the “ultimate” entry age method, the disclosures would also include the implicit amortization period using this more traditional entry age cost method.

2. Amortization methods

Segal recommends that the ASB should require a disclosure that shows a projection of the UAAL based upon the plan’s funding policy. If a plan has no funding policy, the actuary should use his/her best judgment on the methodology to use for the UAAL projection given each client’s facts and circumstances. The projection would be performed with each actuarial valuation and would show the annual UAAL for the duration of the amortization period (or for 30 years if the amortization method has no fixed period), assuming that all assumptions are met and that the contributions are made in accordance with the funding policy.

Segal also recommends that the ASB should require disclosures for these amortization practices:

- Negative amortization – Required disclosures would show the effect and duration of any negative amortization that develops from a plan’s amortization method, such as the number of years until the negative amortization is eliminated, or a projection of the UAAL over the amortization period.

- Fixed rate plans – Required disclosures would show the implicit amortization period derived from a plan's actual contribution rate. If that period results in negative amortization, the disclosures above would be required.

3. Assumptions

Segal believes that ASOPs 27 and 35 are clear, as the rationale for assumptions must be disclosed. It is a separate issue if an actuary does not follow the guidance in these ASOPs.

4. Alternative Liability Measures

Segal recommends that the governing principle should be that the basis for measuring liabilities is driven by the purpose of the measurement. Alternative liability measures that are inconsistent with the purpose of the measurement would result in confusion and misuse of the alternative calculations. Therefore, we believe the actuary should not be required to calculate and disclose any of the "market consistent" alternative liability measures in an actuarial report whose purpose is to present information related either to plan funding or to plan-related accounting and financial reporting under GASB Statements 67 and 68.

Specifically:

1) Solvency or "settlement" liability based on the estimated costs of transferring all risk, including investment and mortality risk, to an insurance company – the purpose of this measurement is to determine liabilities for a pension plan termination, not for ongoing pension plan funding or financial reporting. In addition, there is no insurance company able to assume the liabilities for many public retirement systems, so it is unclear what assumptions would be used or how this information would be useful.

2) A liability based on a Treasury yield curve, to approximate the cost of eliminating almost all investment risk – the purpose of this measurement would be to determine the funding or accounting cost of a plan that is invested in an immunized portfolio, which is not relevant to the funding or financial reporting of a plan that is not so invested.

3) A liability based on discount rates commensurate with the level of risk of the underlying benefit promise – this measurement is a theoretical "market value of liabilities" based upon default risk, which is not a public sector plan funding or accounting measurement.

4) A liability based on a high quality corporate yield curve, for comparability to the discount rate basis used by private sector plan sponsors – this is a corporate plan measurement and has no applicability in determining the funding or financial reporting for a public sector plan.

We appreciate the opportunity to provide input on these important topics. Segal's rationale for including the recommended disclosures in the ASOPs is that these disclosures will provide additional useful information regarding the use of the "ultimate" entry age cost method and negative amortization. The additional disclosures for fixed rate plans will show the effect of the fixed rate on the amortization of the unfunded actuarial accrued liability. Intended users of the actuarial information – as well as any other users – will benefit from the proposed suggestions through a clearer understanding of how these less familiar funding policies work. Segal's suggestions apply to all plans to the extent that they are applicable.

If you have any questions or require any clarification on our comments, please contact me.

Sincerely yours,

Kim Nicholl, FSA, FCA, EA, MAAA
Public Sector Retirement Practice Leader