Members of the Actuarial Standards Board:

The American Academy of Actuaries' Public Plans Subcommittee appreciates the opportunity to submit written comments for the Actuarial Standards Board's (ASB's) hearing on public pension issues. Our written comments focus on the areas of interest identified by the ASB, building on the recent comments we submitted on Actuarial Standards of Practice (ASOPs) and Public Pension Plan Funding and on the Assessment and Disclosure of Risk.

Contribution Allocation Procedures

For public pension plans, the contribution amount may be determined by legislative appropriation, statute, statutes that define a contribution procedure, or a retirement board. These amounts may or may not be based on the advice of an actuary. As such, the ASB and actuary cannot enforce any particular contribution regimen. However, they can control what constitutes an Actuarially Determined Contribution (ADC) and can require disclosures related to any report issued by the actuary. It is also important to allow room for professional judgment to be applied in providing advice in a particular situation so that the actuary can continue to influence decisions and not be seen as trying to impose a specific rule that may not fit that particular situation.

In our response to the request for comments in November 2014, we suggested areas where the ASB could further limit what qualifies as an ADC or require disclosures that would be helpful, including:

1. Precluding rolling amortization combined with negative amortization ("perpetual negative amortization");
2. Requiring that the normal cost under an individual cost method reflect the plan provisions applicable to each individual member and requiring the disclosure of normal cost under an individual cost method; and
3. Requiring calculation of an ADC, with an historical comparison of actual contributions to the ADC.

In addition, the ASB should consider requiring a projection showing the dollar amount of unfunded liability in each future year if all assumptions are realized and contributions made. The length of the projection could be limited if the unfunded liability is never projected to be paid off. While such a projection primarily illustrates the amortization method, it also shows the impact of asset smoothing and any "direct rate smoothing" components of the contribution allocation procedure. If actual contributions differ from an ADC, the projection could be required for both scenarios.

Amortization Methods

In addition to eliminating "perpetual negative amortization" as described in our November 2014 comment letter, we suggest the ASB consider requiring an amortization method illustration, including the pattern of expected future payments and balance of any amortization base. (If our suggestion above on the contribution allocation procedure to project the unfunded liability is not

adopted, we would suggest that plans be required to show the projection for all existing amortization bases combined.)

We do not support specific limits on the length of amortization periods. There is a balance to be struck between benefit security, contribution stability and generational equity. For example, a plan that historically has been pre-funded may be served well by amortization periods of 15 to 20 years. But a 15-year amortization for a plan that has been pay-as-you-go and is switching to a pre-funding strategy would require the current generation to pay the costs of their benefits plus those for the prior generations. The decision of how much burden to place on the current generation for the lack of funding provided by prior generations is largely a political one, and our role as actuaries is to advise, explain, and disclose the implications of the alternatives.

Assumptions

The ASB updated ASOPs 4, 27 and 35 recently, making significant changes to strengthen the process for selecting assumptions. We support giving these updates some time to be incorporated into actuarial practice, before determining that they are inadequate.

Alternative Liability Measures

The appropriate liability measures to disclose depend on the purpose of the measurement. It would be inappropriate to require the actuary to make calculations that are not directly relevant to the intended users based on the purpose of the measurement. The information provided to intended users should also be sufficient for other users to assess the performance of intended users in executing their responsibilities.

The Academy published an Issue Brief in 2013 describing the difference between liability measures using an expected-return-based discount rate and those using a market-based discount rate. In short, expected-return based measures are used to establish a pattern of contributions that accumulates to the amount needed to pay the benefits when due if assets earn the expected return. Market-based measures represent an estimate of the price to settle the obligation or to eliminate the investment risk inherent in the pension plan's investment strategy.

The primary purpose of public pension valuations is to establish or update a pattern of contributions to pay for the promised benefits. The essential measure for this purpose is an expected-return-based measure.

Public pension plans are not generally subject to the types of transactions (e.g., purchase or sale of equity in the corporation) that would make use of a settlement measure. There are exceptions like the withdrawal of an employer from a statewide retirement system. In such a case, it would be appropriate to use a market-based measure.

Another use often suggested for a market-based measure is to quantify the investment risk taken by the plan. The difference between the market-based measure and the expected-return-based measure only represents the price of eliminating the investment risk. This may or may not be useful to the discussion, but to quantify the amount of investment risk to which the plan is

actually exposed, other measures should be used, as discussed in the exposure draft on the assessment and disclosure of risk (including our comments).

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We believe these suggestions would help those who make decisions about how much to contribute to a public pension plan, and the stakeholders who ultimately hold those decision-makers accountable. Furthermore, these suggestions can be incorporated into existing standards and applied to actuarial work for any type of pension sponsor, although in some cases the impact would be primarily on public pension plans.