NATIONAL EDUCATION ASSOCIATION
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Great Public Schools for Every Student

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ASB Comments
American Academy of Actuaries
1850 M Street NW, Suite 300
Washington, DC 20036

Dear Members of the Actuarial Standards Board:

The National Education Association (NEA) respectfully submits these comments to the Actuarial Standards Board (ASB) for the record regarding the proposed changes to ASOP #4.

NEA has serious concerns about the proposal to impose higher costs and more work on retirement systems by forcing actuaries to add a new, unnecessary, and misleading figure to pension reporting. The proposed Investment Risk Defeasement Measure (IRDM), similar to using a risk-free discount rate, would be a political weapon wielded to harm the next generation of workers by weakening or closing pension systems, and it would create confusion without establishing useful new data. Indeed, the IRDM is simply not relevant to public sector pensions.

There is a small, but vocal, group working to undermine public trust and confidence in the actuarial profession, specifically regarding pension funding for teachers, fire fighters, bus drivers, nurses, librarians, and other public employees. They are working in tandem with the well-funded Arnold Foundation efforts to attack public sector employees and eliminate their defined benefit pension plans. These parallel activities will continue even if the ASB imposes an IRDM. In fact, they will likely frame it as actuaries finally admitting that they have misled lawmakers and the public about the "true costs" of pensions. Considering the highly polarized and contentious state of American politics, this is hardly a farfetched scenario.

We are deeply concerned that the ASB is considering violating its own rules and processes to jam through a politicized measure like the IRDM. The Actuarial Standards Board would be well served by recognizing that this proposal is not serious financial work, but political advocacy designed to mislead people and further attack the credibility of your profession.

Our concerns are outlined below.

Comment #1 – IRDM Used to Mislead, Not Inform

The IRDM will be used by individuals who oppose, or who are paid to oppose, pensions for public-sector employees. These groups will use it to deceive the public about pension costs. The ASB should not force pension plans to pay for this type of political work. Typically, these recommended measures stop short of advocating that pension plans are funded using excessively low return assumptions—instead pushing only for disclosure. Moreover, funding plans in this way would cost tax dollars and is one reason why we strongly believe that this effort is about public relations, not economics.

I will provide an example related to the Society of Actuaries' Blue Ribbon Panel's co-chair, Mr. Andrew Biggs, which is relevant given that the panel's report was a stated reason for this ASB decision.

In 2015, when Mr. Biggs came across erroneous CBO data claiming that Social Security replaces 60% of income, he jumped on the opportunity to use this error to mislead people and further his advocacy in a Forbes article titled *"New Social Security Replacement Rate Numbers Cast Reform, Retirement Debates In Different Light,"* by stating:

> *Social Security replaces nearly 60% of pre-retirement earnings. Financial advisers recommend 70% total replacement rate. These numbers don't support expanding Social Security.*

One might assume this was an error, but Mr. Biggs had served as principal deputy commissioner of the Social Security Administration and has even weighed in on technical matters regarding how to accurately measure Social Security's pay replacement levels as far back as 2005. Given that, he undoubtedly knows that Social Security only replaces about 40% of pre-retirement income.

We feel very confident that, if the IRDM proposal is accepted, it will be used in the same manner that Mr. Biggs used the CBO error: to mislead.

Thus, the proposal would force actuaries to violate Precept 8 of the Code of Professional Conduct.

Comment #2 – Exception Made for Narrowly Prescriptive ASOP

It's clear that this particular ASOP will violate the ASB's own norms, which do not allow for "narrowly prescriptive" rules that "neither dictate a single approach nor mandate a particular outcome." We oppose the ASB's effort to break its own rules and norms for this one politically motivated scheme.

Comment #3 – IRDM Not Relevant to Public Plans

The IRDM is not relevant to the public sector. While insurance companies may find the measure useful in trying to win private-sector business via "de-risking" deals, the public sector doesn't engage in these deals because they are simply too expensive once you understand the massive inefficiencies inherent in buying annuities through an insurance company.

We would like to know if insurance actuaries, who may be seeking business gains, are promoting this policy. We are asking for transparency.

Comment #4 – IRDM Is More Problematic for Risk-Sharing Plans

In addition to our concerns about misleading claims being made about the IRDM, the mispricing of plans that have variable benefits and cost-sharing arrangements would be more severe. If pension fund returns really fell by more than half in the future, many public plans would see provisions automatically change.

How would one price a plan where the COLAs are based upon funding ratios or investment returns, if an insurance company was taking on those liabilities? In reality, it doesn't matter. But the IRDM would force decisions to be made about this unrealistic scenario, wasting valuable time and money on speculation.

I believe the proposed IRDM would be even more misleading in regard to these types of plans.

Comment #5 – Another Exception, Rigged Process

Beyond violating the ASB's rules about being prescriptive, another exception was apparently made for the process that produced this controversial proposal. This process appears to have been rigged to get the desired result.

In fact, this process looks every bit as bad as the Blue Ribbon Panel—which excluded pension actuaries, and was stacked with anti-pension political actors—all designed to attack pensions.

Historically, there's a strong correlation between processes getting revised for one specific issue and situations where it was understood that the idea would fail within the normal process. There's also usually some powerful interest(s) who strongly preferred a particular result. The ASB should be transparent about who decided to replace the pension committee with a newly appointed "Pension Task Force," and who actually selected the members of this group.

Unfortunately, it now appears that both the SOA and ASB are rigging the rules *against* pensions—which is astonishing since both organizations purport to represent and serve pension actuaries.

Comment #6 – Do the ASB and SOA Mistrust Their Members?

The current IRDM proposal is the second recent example of an actuarial organization slighting many of its own members—similar to how the Blue Ribbon Panel on pension funding sought and reflected the advice of political interests over pension actuaries. Now, the ASB is cutting the pension committee out of a process that will dictate how their work is performed—decisively avoiding their input.

The ASB should consider whether pension actuaries will continue to see membership in organizations that disregard their expertise and undermine their credibility and profession as valuable.

Comment #7 – Plan Funding Mechanisms Work, but Goal Lines Recently Moved

Let's look at some facts about pension plan returns and funding. To begin with, claims about a crisis arising from poor investment returns are simply wrong.

Returns have actually been fairly strong throughout the awful decade that includes 2008-2010, as plans averaged returns of around 6%—well above the absurdly low rates of return (for pensions, not insurance companies) that the ASB is considering (narrowly) prescribing. Over the 25 years that included the massive crashes around 2000 and 2008, public plans have returned 8.1%. The 30-year returns are even better. In this context, it's quite odd to argue that investment returns will be less than half the level pensions have achieved in the past.

Yet, NASRA notes that the average plan is only 72.1% funded. The seeming discrepancy between returns and funding ratios largely comes from plans reducing their discount rates from around 8% to an average of 7.36% and updating other assumptions, like mortality tables (with most plans now using generational tables).

At this point, public pension unfunded liabilities are more attributable to a combination of setting more conservative funding targets and inadequate sponsor contributions in a few large systems than they are poor investment returns. With proper sponsor funding, public pension plans would still be remarkably well funded when compared to the funding targets that were being used for so many years. The funding formulas actually worked well, and investment returns were not far from those being assumed during a period that included the worst financial crisis since the Great Depression.

Comment #8 – Pensions Are Simply More Efficient than Insurance Companies

It is reasonable that insurance actuaries might look at pension funds' investment returns with awe. Though it may be unexpected that public pensions would outperform well-staffed insurance companies by such a large margin with much lower overhead, it is true.

A few years back, I had to compare an insurance company's finances to a public pension fund to understand why a scheme to privatize annuities would provide such awful value relative to the public system that it was replacing. The insurance company's inefficiency, relative to a public pension system, was simply stunning. Two key factors stood out.

- Insurance companies cannot invest like pension funds, instead forced into low-yield securities, while forgoing the widely acknowledged risk premium that long-term investors enjoy.
- The other major factor was that a far smaller portion of the insurance company's revenues went toward actually providing benefits. With overhead around 30% of revenues, profits and taxes at 10% and 5%, respectively, it's simply impossible to generate the efficiency that our public pension plans bring to the table. In that specific case, the public plan expenses were only 1.3% of revenues.

If you think about it, this actually does make sense. A public pension doesn't need to maintain a sales force across the country, run nationwide advertising campaigns, lobby politicians, or any of the other activities businesses undertake. In contrast, pension funds can run efficiently, providing maximum value to both taxpayers and beneficiaries.

Comment #9 – IRDM: Designed to Make Pensions Look Bad, but Will Illustrate Their Comparative Efficiency Versus Insurance Firms

Given that funding mechanisms do work well, the ASB proposal to disclose figures calculated based upon 3-4% returns, while plans are funded using an average discount rate of 7.36%, will, by definition, make pensions look underfunded—which I believe is the whole point.

In truth, the difference between these two liability measures (IRDM and accrued liabilities) will really represent the enormous gap in efficiency achieved at pension funds, relative to insurance companies.

Conclusion

We are deeply concerned that the ASB is considering playing a role in this destructive campaign that has such long term negative impacts on public services and public sector employees.

With political groups waging broad attacks on public pensions and public education, it's no wonder that a real crisis is emerging. Young people comprehend these attacks on public services, and those who provide them. As a result, the number of U.S. college students studying to become educators has fallen by 42% since 2009-2010. This emerging teacher shortage will leave us with either larger class sizes or more classrooms lacking well-trained educators, a Sophie's choice if you care about education.

We thank you for your time and appreciate the opportunity to submit these comments.

Sincerely,

Dan Doonan
Senior Pension Specialist