



July 30, 2018

ASOP No. 4 Revision
Actuarial Standards Board
1850 M Street, NW, Suite 300
Washington, DC 20036

Members of the Actuarial Standards Board:

The Kansas Public Employees Retirement System (KPERS) has reviewed the Exposure Draft of proposed revisions to ASOP 4 (Measuring Pension Obligations and Determining Pension Plan Costs or Contributions). We appreciate the opportunity to respond to the proposed changes.

KPERS is a governmental, multi-employer pension plan covering state employees, teachers, local units of government, public safety, and judges. KPERS does not have an actuary on staff, but we do contract actuarial services for our annual funding valuation and cost study information, primarily for use with the plan sponsor, the Kansas Legislature.

Our response is focused on the practical implications of the proposed changes and the challenges that we will face if changes are not made to the exposure draft of ASOP 4. We do not presume to know what should be considered actuarial best practice, however we feel it is necessary to look at proposed changes in the context of their use within the public pension arena. While we have reviewed the entire Exposure Draft, this response is focused on section 3.11 - Investment Risk Defeasement Measure.

Section 3.11 – Investment Risk Defeasement Measure (IRDM)

As we understand the proposed changes, the IRDM would be a new measurement of liabilities that would be required to be included in the annual funding valuation. Although the use of the term “should” in the first paragraph of section 3.11 does not explicitly require the calculation, within the context of the entire document we believe that is the intention. A new obligation measure within the annual funding valuation with a different, prescribed set of assumptions and a different cost method is the primary cause for concern from our perspective as a public plan administrator.

Prescribing a new obligation measure in the annual funding valuation would cause confusion for legislators, stakeholders and the media. The confusion would stem from having two different measures of plan liabilities as of the valuation date in the same report. Despite explanations and disclosures of the differences between the measures and each measurement’s purpose, the two measures would almost certainly be compared to one another and used out of context. This could lead policymakers to believe that one set of numbers is “correct” and they must choose between the two rather than understanding the different goals of the annual funding valuation and the IRDM.

We have already seen this to a certain degree with the “net pension liability” calculated under the Governmental Accounting Standards Board (GASB) Statement 67 being used interchangeably by the media, members and legislators with the “unfunded actuarial liability” calculated in KPERS’ annual funding valuation, despite our best efforts to educate all parties on the differences between the measures.

Part of KPERS' role is to educate all interested parties on the differences as well as the purposes of the different measures. However, as a public entity, KPERS' freely publishes the annual funding valuation. It is logistically impossible to ensure the IRDM would be used properly by all of the parties that access the annual funding valuation. This confusion would erode trust between KPERS and our members and the Legislature.

Calculating contingent benefits is not specified in the IRDM. Recent pension reforms in Kansas included the implementation of a risk-sharing cash balance plan (KPERS 3). Part of the KPERS 3 plan design includes dividend interest credits contingent upon actual investment returns. KPERS 3 members receive a guaranteed 4% annual interest credit on their notional retirement credit and employee contribution accounts, with the possibility of receiving additional interest credits if the 5-year average return on the market value of assets meets or exceeds certain investment benchmarks.

For purposes of the annual funding valuation, an assumption for the receipt of dividend interest credits is used when projecting benefits and calculating the actuarial liability. The interest dividend assumption is consistent with all other economic actuarial assumptions used in the annual funding valuation and is based on the expected return and standard deviation of the KPERS' portfolio. The interest dividend assumption anticipates the expected additional member benefits arising from the System taking risk with a prudent, diversified portfolio. Although the cash balance benefit structure is relatively new in Kansas, we have already granted this additional employee benefit.

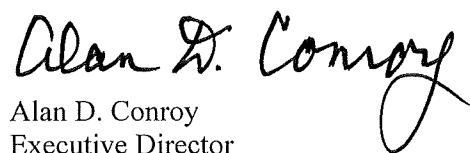
Section 3.11 states, in part, that the IRDM should be calculated using "assumptions other than the discount rates used in the funding valuation." However, using the assumption from the annual funding valuation for the contingent interest dividends as the assumption in the IRDM would be inconsistent with the prescribed assumptions in 3.11. On the other hand, changing the assumption for the contingent interest dividends for the IRDM does not reflect the actual benefit structure of the plan. It is simply not clear which approach would be viewed as appropriate in the context of ASOP 4. Are we supposed to assume that benefits are reduced along with the investment risk, or that with risk reduced assets, the legislature would grant benefit increases as though the risk had still been taken?

Conclusion

The addition of the Investment Risk Defeasement Measure (IRDM) in the Exposure Draft of proposed revisions to ASOP 4 causes practical problems for KPERS as a public plan administrator, and we believe that to be true for other public plans as well. We do not question the intentions of the Actuarial Standards Board in the proposed changes. However, we do not believe that the practical ramifications of adding the IRDM to the annual funding valuation have been fully considered. In our opinion, the negatives associated with including this liability measure in the valuation report far outweigh any positive impact.

For this reason we request that the Actuarial Standards Board remove the IRDM from the Exposure Draft of proposed changes to ASOP 4 and consider an alternative approach to achieve the goals of the Board. Thank you for your consideration.

Sincerely,


Alan D. Conroy
Executive Director