Comment #1 – 5/18/18 – 5 p.m.

This email presents my comments on the proposed revision to ASOP 4. I emphasize that my comments are personal and do not necessarily represent the views of my employer or of any actuarial body of which I am a member. I am a Fellow of the Institute of Actuaries (London), a Fellow of the Society of Actuaries, An Enrolled Actuary, and a member of the American Academy of Actuaries.

1 The ability of myself, other actuaries, and other interested parties to comment on this proposed revision would be greatly enhanced – to a minimum acceptable level – if the ASB issued a red line version of the proposed revision, using strikeout font for text in the original that the ASB proposes to remove and by using italic/different color font for text the ASB proposes to add. Such a version is essential for us to make a reasonable review of the changes and to catch areas where the changes appear to need further revision or removal. I urge the ASB to provide red line versions for all future proposed revisions of ASOPs and to provide red line versions of all current draft ASOPs that are proposed revisions of existing ASOPs.

2 I urge removal of 3.11, which discusses Investment Risk Defeasement Measure, for these reasons:

- Section 2 contains no definition of Investment Risk Defeasement Measure, Defeasement, Investment Risk Defeasement, or Defeasement Measure. Before accepting a revised ASOP with 3.11, the ASB should submit for fresh review a version that includes such definitions. The lack of definition is an insuperable hurdle for allowing adoption without exposing a new draft for further review.

- Section 4.1.o. provides inadequate guidance on the communication of this measurement. Inclusion of a value and information on the assumptions used, without contextual information on how the actuary's principal is expected to understand or use the information is unhelpful.

- SAOs on retirement plans typically include measures of funding target using constrained and unconstrained interest rates, 4010 liability values, the present value of accrued benefits under ASC960, PBO, DBO, ABO, and VBO. Multiemployer plan SAOs include withdrawal liability. I question the need, value, or appropriateness of adding a measure of Investment Risk Defeasement to this array of existing actuarial values.

- The actuary's principal should have authority to determine if the actuary should calculate this value based on the value of the information and the cost of the actuary performing the calculation and revising the SAO to include communication of it.

- In many situations, the measure will be of no relevance to the actuary's principal. Such situations include a plan with all benefits fully covered by the PBGC; plans with assets far in excess of even the most conservative measure of liabilities, multiemployer plans that are not in the green zone, terminated single employer plans, and plans with a funding policy contribution more than adequate to eliminate the need for this measure.

• The requirement of 3.11.d. on demographic assumptions is worse than worthless; it emphasizes funding valuation assumptions, although such assumptions may be inappropriate for (a) a situation in which the plan sponsor decides to defease the investment risk of the plan or (b) a situation in which large numbers of plan sponsors decide to defease the investment risk. Other ASOPs require the actuary to adopt appropriate assumptions; ASOP 4 is no place for 3.11c. or 3.11d.

3 I urge the ASB not to change the ASOP to reflect the proposed addition or modification of 3.14, 3.16, 3.17, 3.20, 3.21. and 4.1. - and the corresponding definitions in Section 2. They make the ASOP too prescriptive. Far from adding these parts, I urge the ASB to review the ASOP with a view to removing from it all of the prescriptive wording and making it a general ASOP that allows actuaries working in the retirement income area to adopt appropriate measurement procedures and to discuss them in appropriate detail in any SAO. The proposed additions to the ASOP and much of the existing entries in sections 2 and 3 belong, not in an ASOP, but in actuarial textbooks, informal guidance, blogs, and discussion papers.

Meetings of the ASB and of the ASB Pension Committee that will discuss the comments on this proposed revision will be under different rules from those that applied in the past. The meeting chair can now prohibit attendance by anyone for any reason and for no reason. The ASB should have sought input from the Academy membership before piggybacking on the changes adopted for Academy board and committee meetings. I urge the ASB, as a separate entity from the AAA, to sever its meeting attendance policy from the policy for the Academy meetings and adopt a modern web-based attendance policy that would make live webcasts of all ASB board and committee meetings (similar to C-Span) readily accessible to anyone, and to provide an accessible library of recordings of past such meetings. I am confident the ASB could provide appropriate rules for those rare situations where the confidential nature of some discussion merits in-camera treatment. The ASB refuses to post or consider anonymous comment communications on draft ASOPs. The ASB and its pension committee should not adopt a "do as I say, not as I do" approach, by holding meetings that those interested in the ASOP have no guarantee of attending (thereby, being unable to identify the people on the committee or board whose comments lead to welcome or unwelcome changes).

An unresolved conflict of interest could exist if an actuary's work on the ASB or any ASB committee could affect (a) any client of the actuary, or (b) any other direct or indirect financial interest of the actuary. I urge the ASB to publish standard statements by each member of the ASB and of each of its committees prior to participating in any ASB-related meeting that attest to (a) having received approval from each client to perform work on the ASB or ASB committee at that meeting regardless of if that work affects that client and (b) having no material conflict of interest in any other matter in relation to ASB board or committee work.

Best Wishes

Jan Harrington

California Actuarial Advisory Panel

June 25, 2018

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

SUBJECT: Comments on the 2018 Proposed Revision of Actuarial Standard of Practice (ASOP) No. 4

The California Actuarial Advisory Panel (CAAP) supports the ongoing improvement of Actuarial Standards of Practice (ASOPs) and appreciates the opportunity to provide input to the Actuarial Standard Board (ASB) on the proposed changes to ASOP No. 4 related to measuring pension obligations and determining pension plan cost or contributions.

The CAAP was created with the passage of California Senate Bill 1123 in 2008 and consists of eight public sector actuaries appointed by public officeholders and agencies. Pursuant to California Government Code section 7507.2(2):

> "… the panel shall provide impartial and independent information on pensions, other post-employment benefits, and best practices to public agencies…."

As members of the CAAP, our background is in public plans, and many of our comments are made from the perspective of these plans, but we also believe that most of these comments are not limited to a public plan context.

Our comments are divided into sections – first, we submit a number of technical comments with respect to the Investment Risk Defeasement Measure (IRDM). We then make a series of more general arguments as to why the requirement to publish the IRDM is inappropriate. We conclude by making comments on other areas of the proposed ASOP No. 4 changes.

State Controller's Office
California Actuarial Advisory Panel
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Technical arguments related to the IRDM

Our technical comments with respect to the IRDM can be summarized simply: as currently defined, the IRDM is not an appropriate measure for communicating the stated purpose of the measure – i.e. measuring the cost to defease the investment risk for a pension plan. If this is the true purpose, then the language in ASOP No. 51[1] should be applicable:

> "Methods may include, but are not limited to scenario tests, sensitivity tests, stress tests, and a **comparison of an actuarial present value using a discount rate derived from minimal-risk investments to a corresponding actuarial present value from the funding valuation or pricing valuation**."

We note that in the highlighted section, the Pension Committee of the ASB (rightly) pointed out that to show the cost of defeasing the investment risk, there must be a comparison made to an actuarial present value computed as part of the funding valuation, i.e. a present value from the valuation that is computed using a discount rate which reflects the expected rate of return on plan assets. However, in the public sector, we are not aware of any public plans that regularly publish an actuarial present value based on a Unit Credit funding method and using the expected rate of return on assets that are not invested on a risk free basis.

The reasons for this are straight-forward: as public plans generally cannot be terminated based on salary at the termination date (as opposed to the salary at the retirement date), any liability measure which does not take into account future expected pay increases would be underestimating the funding targets / liabilities of the plan. As a result, the appropriate measure for determining the cost to defease the investment risk of a plan would need to be one based on a cost method that does incorporate future expected salary increases – such as the Projected Unit Credit (PUC) or Entry Age Normal.

A secondary technical issue related to the IRDM is that, as currently defined, it would not provide a reasonable measure of defeasing the investment risk for plans with strong risk mitigating plan designs. Consider a plan with a variable benefit design where the target benefit is based on the expected return on assets, and where benefits are reduced if actual returns are below the expected return. For such a plan, if an actuary were to project benefit payments using the assumptions from the funding valuation (as specified under the proposed 3.11d) and then discount the projected benefits using Treasury or other fixed-income yields, the resulting present value would greatly exceed the actual cost of defeasing the investment risk. Depending on the strength of the risk-mitigating features, the

[1] ASOP 51, Section 3.4 (Methods for Assessment of Risk), emphasis added

appropriate measure may in fact still be the original liability that was based on a discount rate equal to the expected return on assets.

IRDM Disclosure Requirement in the Context of the Other ASOPs

We appreciate that comments on Exposure Drafts should focus on the proposed guidance, and our comments above on the IRDM focus on that guidance.

However, the shortcomings of the IRDM as a practical measure of the cost to defease investment risk invite the question of why it has been proposed as a universal disclosure requirement, and whether the process that led to that proposed requirement is appropriate and consistent with the ASB's established methods and procedures for standard setting.

This consideration of process is especially important because the IRDM disclosure requirement is such a break from the ASB's past practice. For all of its years of operation, as clearly stated in the foundational ASOP No. 1, the ASB has issued standards that are "principles-based"; they "are not narrowly prescriptive and neither dictate a single approach nor mandate a particular outcome."[2]

The reasoning for this approach is also clearly stated in ASOP No. 1, and is worth citing in detail:

> "…ASOPs provide the actuary with an analytical framework for exercising professional judgment, and identify factors that the actuary typically should consider when rendering a particular type of actuarial service. The ASOPs allow for the actuary to use professional judgment when selecting methods and assumptions, conducting an analysis, and reaching a conclusion, and recognize that actuaries can reasonably reach different conclusions when faced with the same facts."[3]

Thus, it is no exaggeration to observe that principles-based guidance is one of the foundations of our profession. In contrast, the proposed revisions to ASOP No. 4 reverse this precedent by prescribing one specific disclosure under the IRDM provisions of Section 3.11. This reversal compels careful consideration in the context of the development and guidance of other relevant ASOPs.

In addition to being prescriptive, a clear criticism of this particular requirement is that, if the IRDM is intended as a measure of risk, then its disclosure should have been addressed in ASOP No. 51. In fact, ASOP No. 51 "…does not require the

[2] ASOP 1, Section 3.1.4
[3] See also actuarial Code of Professional Conduct, Precept 10, Annotation 10-1, which reads, "Differences of opinion among actuaries may arise, particularly in choices of assumptions and methods."

[risk] assessment to be based on numerical calculations,"[4] let alone specifying a specific measure. In developing ASOP No. 51, the ASB did at first propose requiring a quantitative assessment of risk for large plans,[5] but rejected that requirement in the final standard. It is inappropriate for the ASB to now reverse that guidance, especially considering the full, deliberative process that led to removing any quantitative disclosure requirement in ASOP No. 51.

Still in the context of ASOP No. 51, even if the IRDM were a useful measure of investment risk defeasement, for many plans that is not a useful metric for helping principals and stakeholders understand their investment risk. The IRDM seeks to measure the cost of investment risk avoidance or aversion, rather than illustrating the possible implications and consequences of taking on investment risk. ASOP No. 51 suggests other more useful methods for assessment of risk that focus on possible outcomes, including scenario tests, stress tests and stochastic modeling.[6] While we agree with ASOP No. 51 that no particular quantitative risk assessment should be a universal requirement, any of these would be more generally applicable than the theoretical cost to defease a plan's investment risk.

The IRDM disclosure requirement is also inconsistent with both the process and the guidance of the 2014 revisions to ASOP No. 4 (December 2014) and ASOP No. 27 (September 2014). These revisions were the result of an exhaustive, three-year process that included an ASOP No. 4 Discussion Draft, two Exposure Drafts for each standard, and a subsequent Working Draft of ASOP No. 27. Note in particular that this review gave full consideration to a request from the AAA Board[7] that the ASB "develop standards for consistently measuring the economic value of pension plan assets and liabilities. (Here "economic value of liabilities" is another term for what the ASOP No. 4 Exposure Draft calls the IRDM, and what is commonly referred to as the "market value of liabilities".)

However, in those revisions to ASOP Nos. 4 and 27, the ASB did not develop such a standard, market-based measure of liability. Instead, the ASB took the more appropriate approach of focusing on the "purpose of the measurement", both when measuring pension obligations[8] and when selecting a discount rate.[9] This "purpose of measurement" consideration is, perhaps, the single most useful and insightful pension guidance found in any actuarial standard. That guidance,

[4] ASOP 51, Section 3.3
[5] ASOP 51 First Exposure Draft, December 2014, Section 3.7
[6] ASOP 51, Section 3.4
[7] From an October 8, 2008 AAA press release: "The American Academy of Actuaries' board of directors has asked the Actuarial Standards Board to develop standards for consistently measuring the economic value of pension plan assets and liabilities. The board also has determined that it will not issue a public advocacy statement on the issue at this time."
[8] ASOP 4, Section 3.3
[9] ASOP 27, Section 3.9

together with the guidance from ASOP No. 51, is fully sufficient to guide practice when the purpose of the measurement is the assessment of risk.

The proposed IRDM disclosure requirement is not only inconsistent with ASOP No. 51; it is also inconsistent with the "purpose of measurement" guidance in ASOP Nos. 4 and 27. For a particular measure to be universally required, it would have to fulfill some universally applicable purpose. As discussed above (and as implicit in ASOP No. 51) the IRDM is not a universally appropriate or useful measure for the purpose of risk assessment. This means that, absent some other universally applicable purpose, the IRDM disclosure requirement is arbitrarily prescriptive in a manner inconsistent with the fully deliberated provisions of ASOP Nos. 4 and 27.

For the above reasons, we recommend that the ASB rescind the IRDM disclosure requirement and allow practice to develop under the "purpose of measurement" guidance of ASOP Nos. 4 and 27 and the risk assessment guidance of ASOP No. 51.

"Purpose of Measurement" Considerations Related to the IRDM

The ASB's robust process in revising ASOP Nos. 4 and 27 is also revealing as to the purpose of the particular measurement being proposed as the IRDM. This measure – an accrued benefit present value discounted at current market yields on low risk fixed income investments – is well known in pension practice. Under the 2014 revisions to ASOP No. 4 and 27 it is identified by purpose as a "market value assessment" (ASOP No. 4) and a "market-consistent measure" (ASOP No. 27).[10] However, for most of its history its purpose, in various forms, was as a settlement measure, including the PBGC withdrawal liability, the FASB standards accrued benefit obligation and the ERISA current liability.

Given the marginal utility of the IRDM as a risk measure, we would ask that the ASB acknowledge that the most commonly understood purpose of this measure is as a settlement value, to reflect the cost of settling pension obligations at a current risk-free discount rate. This purpose is even explicit in one of the discount rate bases for the IRDM stated in the Exposure Draft. Once that purpose is acknowledged, it is inappropriate to require the disclosure of the IRDM for a pension system that cannot settle its obligations in that manner. In particular, many public sector systems have found through legal analysis and court actions that they cannot freeze their pension accruals and settle their obligations the way a private employer could with a private pension plan. Also, many state and municipal public employers have no legal framework that would allow them to withdraw from the pension plans they sponsor. Thus performing a liability

[10] ASOP 4, Section 3.3 and ASOP 27, Section 3.9 c

calculation reflecting only current salary and service is not useful or meaningful, and is in fact misleading.

Accordingly, if any IRDM disclosure requirement is retained, then any "should disclose" requirement should not apply to the obligations of any employers who cannot in fact settle their obligations. For such obligations, the most that the ASOP should require is that the actuary "should consider disclosing" the IRDM, either as a what-if settlement value or as an alternative risk measure under ASOP No. 51.

Finally, beyond its role as a settlement value, any complete and candid discussion of the proposed IRDM disclosure requirement must acknowledge that this is simply a new name for what is known in the financial economic literature as the Solvency Value.[11] This is most clear in the February 2016 report and "suggestions" prepared by the ASB's Pension Task Force. We ask the ASB to consider carefully that re-characterizing the Solvency Value as a measure of investment risk defeasement does not change its actual purpose. That purpose is to provide financial economists with the value that, according to their market based economic theory, is not a measure of investment risk but rather is the true value of any pension obligation.[12]

If the actual purpose of the IRDM is to fill the needs of financial economic models then those who need that value for that purpose should define and calculate it. Actuarial valuations for the purpose of funding should not be required to include a particular value whose principal purpose is unrelated to determining funding requirements.

Solvency Values and Precept 8 of the Actuarial Code of Conduct

Once the IRDM is properly identified as the Solvency Value from financial economics, there are immediate concerns as to how this value will be represented by its proponents to the public. The press and current pension literature are replete with statements by financial economists that the Solvency Value is the only valid measure of a pension obligation and that actuarial practice based on other measures is deceiving the public.[13]

[11] See for example the "Pension Actuary's Guide to Financial Economics," Joint AAA/SOA Task Force on Financial Economics and the Actuarial Model, 2006. Here "Solvency" has a specific technical meaning unrelated to the common understanding of solvency and insolvency.
[12] In theory, the financial economists' "Market Value of Liability" uses a discount rate that reflects the default risk of the pension obligation while their "Solvency Value" uses a discount rate that is "risk free", i.e., reflects no default risk. In practice, the risky discount rate is difficult to quantify, and the value desired by the financial economists is the Solvency Value based on the "risk free" rate.
[13] See the appendix to this letter for a small sampling of such statements.

In the actuarial Code of Professional Conduct, Precept 8 and its Annotation read:

> PRECEPT 8. “An Actuary who performs Actuarial Services shall take reasonable steps to ensure that such services are not used to mislead other parties.”
>
> ANNOTATION 8-1. “An Actuarial Communication prepared by an Actuary may be used by another party in a way that may influence the actions of a third party. The Actuary should recognize the risks of misquotation, misinterpretation, or other misuse of the Actuarial Communication and should therefore take reasonable steps to present the Actuarial Communication clearly and fairly and to include, as appropriate, limitations on the distribution and utilization of the Actuarial Communication.”

Actuaries understand that the selection of a measure of a pension obligation depends on the purpose of the measurement, and that there is not one, true measure compared to which all other measures are deceptive to the public. And yet we know that is how the Solvency Value – by whatever name – will be used by its proponents. We urge the ASB to consider very seriously that no amount of clearly presented “limitations on … utilization” will prevent the IRDM from being “used to mislead other parties” by claiming that its purpose is to measure the true cost of the pension promise. Making it a mandated calculation will almost certainly be claimed as further evidence that is the only true measure of cost.

Other Comments Not Related to IRDM

So far, our letter has concentrated on the proposed requirement to disclose an IRDM. We conclude with comments and recommendations on other areas of the proposed changes to ASOP No. 4. Our comments are indicated by reference to sections of the Exposure Draft.

Section 3.14 – Amortization Method. Many amortization methods determine amortization payments for each separately identified portion of unfunded actuarial accrued liability, a method often called “layered amortization.” We recommend that for such plans the conditions of Section 3.14 could apply either to each amortization base or layer individually, or to the aggregation of all bases. This clarification is particularly important for Section 3.14(b) since in any given year, as some bases are fully amortized, the net amortization amount could in that single year increase more rapidly than expected payroll. We believe either application would be consistent with the intent of the new guidance.

Section 3.16 – Output Smoothing Method. In general, the CAAP supports the proposal to include guidance related to output smoothing methods. We recommend a minor change to Section 3.16 to better reflect plans that have incorporated output smoothing into the structure of their amortization payments.[14] We suggest that the body of Section 3.16 follow the text of 3.16(a) by referring to "a corresponding actuarially determined contribution without output smoothing." Then subsections (a), (b) and (c) should all refer to "the corresponding actuarially determined contribution without output smoothing." Note this would add the words "without output smoothing" to subsections (a) and (c) which we believe was a drafting oversight.

We also recommend that the Section 3.16 guidance on output smoothing be made consistent with the ASOP No. 44 guidance on the selection and use of asset valuation methods. We note that 3.16(a) and (b) closely follow Sections 3.3(b)(1) and 3.3(b)(2) of ASOP No. 44. However, Section 3.3 of ASOP No. 44 also includes the following additional guidance:

> "In lieu of satisfying both (1) and (2) above, an asset valuation method could satisfy section 3.3(b) if, in the actuary's professional judgment, the asset valuation method either (i) produces values within a sufficiently narrow range around market value or (ii) recognizes differences from market value in a sufficiently short period."

We recommend that Section 3.16 should include guidance corresponding to this "sufficiently narrow range" and "sufficiently short period" guidance from ASOP No. 44 Section 3.3. This would provide that:

> In lieu of satisfying both (a) and (b) above, an output smoothing method could satisfy section 3.16 if, in the actuary's professional judgment, the output smoothing method either (i) produces values that fall within a sufficiently narrow range around the corresponding actuarially determined contribution without output smoothing or (ii) recognizes any differences between the smoothed contribution and the actuarially determined contribution without output smoothing within a sufficiently short period of time.

Section 3.20 – Reasonable Actuarially Determined Contribution. We commend the ASB for proposing that an actuary performing a funding valuation should calculate and disclose an Actuarially Determined Contribution (ADC). The CAAP supports the disclosure of an ADC for all plans when performing a funding valuation, including plans where the funding policy (as referenced in Section

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[14] This approach is generally intended to mimic the effect of asset smoothing without actually incorporating an asset smoothing method. It has been adopted by several retirement systems in California, including CalPERS and some independent county retirement systems.

3.19) may determine contributions without reference to an ADC, such as a plan with a statutorily fixed contribution rate. For such plans, we recommend that the ASB require that the ADC should be determined independent of any non-ADC based funding policy, rather than being developed to match the contributions set by such funding policy.

We also concur with the guidance of Section 3.20(b) that the normal cost should be based on the plan provisions applicable to each participant. We understand this is meant to preclude use of what is sometimes called the "ultimate entry age method" where the normal cost associated with a new tier of benefits is applied even to members who do not participate in the new tier.

Conclusion

The CAAP believes that our standards of practice should remain principles based and avoid imposing prescriptive requirements on actuaries, particularly requirements that do not fulfill some universally applicable purpose. Accordingly, while we concur with most of the proposed changes we recommend strongly against the proposal that the IRDM, a Solvency Liability type of measure, be made a required disclosure as part of every funding valuation. If any IRDM disclosure requirement is retained, then any "should disclose" requirement should be changed to "should consider disclosing."

Thank you for considering our responses and please do not hesitate to contact us if you have any questions.

Sincerely,

Paul Angelo
Chair, California Actuarial Advisory Panel

Appendix

cc: Panel members
John Bartel, Vice Chair
Ian Altman
David Driscoll
David Lamoureux
Steve Ohanian
Graham Schmidt
Scott Terando

California Actuarial Advisory Panel
Comments of 2018 ASOP 4 Exposure Draft Appendix

Public Statements on the Use of Discount Rates Based on Expected Return to Value Public Pension Liabilities

On pages 6 and 7 of our comment letter, we describe Code of Professional Conduct Precept 8 issues related to the proposed required disclosure of an Investment Risk Defeasement Measure (IRDM). This accrued benefit present value is generally based on a default-risk free discount rate and is known in the financial economic literature as the Solvency Value. Our comments note that the press and current pension literature are replete with statements by financial economists and others that the Solvency Value is the only valid measure of a pension obligation and that actuarial practice using a discount rate based on expected investment returns is deceiving the public.

Here is a small sampling of such statements; a more comprehensive compilation can be provided to the ASB upon request. The last quote illustrates the related risk that calling for use of a risk-free discount rate as an alternative measure is often misinterpreted as calling for a lower investment return assumption and correspondingly higher contributions.

"However, these [revised governmental accounting] standards still preserved the basic flaw in governmental pension accounting: the fallacy that liabilities can be measured by choosing an expected return on plan assets."

> Joshua D. Rauh in "Hidden Debt, Hidden Deficits: 2017 Edition", A Hoover Institution Essay, May 2017

"Public pensions not accurately disclosing liabilities, study says.
State and local public pensions are undervaluing the true extent of their obligations, a study from the Hoover Institution says."

> Nick Thornton, Benefits Pro article, April 12, 2016, referencing 2016 Edition of Joshua Rauh study

"By relying on inflated discount rates—reflecting the long-term average of past asset returns but failing to account for short-term volatility or market risk—state and local pension funds across America have obscured the true size of their liabilities."

> Edmund J. McMahon and Josh B. McGee, "The Never-ending Hangover -- How New York City's Pension Costs Threaten Its Future, Manhattan Institute Report, June, 2017

"Notice how CalPERS is choosing to value liabilities at the same rate as it expects to earn on assets. … As Nixon said, it's the lie that gets you. CalPERS's lies harm citizens. By linking discount rates to investment return assumptions, CalPERS and its sister pension fund, CalSTRS, are being untruthful. The lies get exposed when citizens get hit with pension deficits."

> David Crane, "It's the Lie That Gets You" medium.com article, March 4, 2017

"That is why a study performed by the **Pension Task Force of the Actuarial Standards Board** concluded that U.S. government pensions are underfunded by $5 trillion. In other words, if those pension funds tried to buy annuities from insurance companies to fund the future benefits they have promised, they would be short $5 trillion.

The Pension Task Force recommended that pension funds switch to using a "market rate of return" as a method to guarantee future benefits for retirees. **The expected rate of return would be lower, so the government employers would need to contribute more**."

Mark Sievers, Daily Republic article, May 22, 2017, emphasis added

Comment #3 – 6-25-18 – 4:44 p.m.

Comments on ASOP 4 Exposure Draft
June 25, 2018
R. Evan Inglis, FSA, CFA
610-608-1578

Thank you for the opportunity to comment on **ASOP 4** on measuring pension obligations and costs. The new ASOP 4 is an important development for the profession.

PVAB or PVVB

The PVAB (PVVB) provides information about benefit security and/or settlement costs. This concept should always be measured with an objective, low risk discount rate. Measuring the value of benefits that have been accrued to date with a subjective, risky expected rate of return discount rate would seem to provide little useful information for any pension stakeholder, unless the approach to funding is based on the PVAB. The practice of calculating a PVAB or PVVB with the expected rate on return on a portfolio of risky assets should be eliminated, or at least, discouraged to improve the information value and comparability of this important measure.

INCLUSION OF A MARKET-SENSITIVE MEASURE

The inclusion of the investment risk defeasement measurement is a valuable addition to actuarial practice. The simple disclosure of this measure is unlikely to have a significant impact on managing pension risk, but it is a first step. Significant impact will come when the actuarial profession, and others concerned with managing pension risk, adopt a market-based perspective. Including an IRDM type measure is helpful in developing that perspective, but the full perspective comes with focusing on and applying market information in all areas of pension management. This perspective would then impact assumption setting and funding, investment strategy and benefit design.

<u>FUNDING</u>

Market-sensitive measures like the IRDM are responsive to information in financial markets at the time of pension valuation. Expected return discount rates should also be responsive to market conditions to best estimate future returns. Bond yields, equity price-to-earning ratios (the inverse of a yield), real estate "cap rates" and other yield or price information is highly correlated with future returns. Today's methods for estimating future returns imply a term structure for expected returns, just as there is for bond yields. In other words, in any particular model, returns will be different for different future periods, depending on the assumed change in prices or yields in any prior period. Thus expected returns should be applied to future cash flows based on the expected return for the time frame for each cash flow. Without these two aspects of market-sensitive measurements (sensitivity to prices & yields and alignment with the cash flows being discounted), expected return discount rates produce misleading funding targets.

<u>INVESTMENTS</u>

Investment managers for plans that do not use a market-sensitive liability measurement do not typically understand how to align assets with the pension liability. Such issues as the right bond duration for reducing risk and the inflation-sensitivity of the liability are not taken into account in designing portfolios which creates unnecessary asset-liability risk for the pension plan sponsor.

BENEFITS

The true risk and cost related to benefit provisions with guarantees (e.g. a 5% return on an account feature) or optionality (e.g. a COLA which fully reflects inflation up to 2%, and only ½ of inflation above 2%) are understood better in the context of market-sensitive measurements, partly because the lack of potential for hedging these types of benefit promises is more apparent.

Anything the ASOPs can do to encourage this perspective will enhance the management of pension risk and reduce the potential for default on benefit payment promises and financial distress for plan sponsors.

POTENTIAL ISSUES WITH THE IRDM

It's important to understand what "effectively settled" really means. It should be understood that "bond matching" exercises to determine discount rates are theoretical and cannot be replicated in the real world. Except for payments beyond 30 years, it is possible to match most expected pension payments precisely with Treasuries and Treasury STRIPS. However, acceptable matching can be achieved with corporate bonds in order to settle a pension obligation at a lower cost. There are a number of considerations applicable to settling a pension obligation with corporate bonds.

- Investment management fees. Any "settlement" based on the creation of an investment portfolio will require that a management fee be paid or that the expense of managing the portfolio be paid directly. These fees are likely to be in the range of 10 bps – 80 bps, depending on the size of the plan and other factors, and will decrease the effective yield on the portfolio.
- Availability of bonds in the two highest rating categories. It is not possible to create a portfolio of AA and AAA bonds with cash flows that match payments for most pension plans because of the small number of bonds in these rating categories. Also, many of these bonds are not available for purchase because they are so often held to maturity by investors like insurance companies. Or, they may not be available for purchase in the market in the quantity needed to fully fund the liability, especially for larger plans.
- Availability of bonds that mature 10-20 years in the future. It is particularly challenging to find bonds that mature beyond 10, but less than 20 years in the future. Corporate bonds are typically only issued with 10 year maturity or 30 year maturity. Real world matching portfolios are usually short exposure in the 10-20 year range and long exposure in the 22-30 year range.
- Reinvestment risk. Bonds are not generally available to fund cash flows beyond 30 years. In addition, bond portfolio cash flows do not typically match the expected payments from a pension plan precisely because the structure of bond payments (small coupons paid until the final debt is paid at maturity) does not align well with a typical pension payment profile (relatively high in the first year, growing some for several years and then gradually decreasing to zero over many years). That means that coupons must be reinvested at a yield which is not known at the time of the original portfolio construction.
- Transaction costs and holding cash. There is an initial cost to creating a portfolio due to illiquidity in the corporate bond market. Because bond portfolio payments do not align precisely with expected pension payments and because expected payments change over time, it

is necessary to buy and sometimes to sell (for example if a bond is downgraded) bonds which generates transaction costs mostly related to illiquidity. In addition some cash is held by a portfolio from the time the cash is generated (for example by a coupon payment) until the time it is needed to make benefit payments.

- Defaults and downgrades. If a portfolio of AA and AAA bonds is created, then some of the bonds may eventually default and not make the intended payments. When a bond in a settlement portfolio is downgraded out of the universe of the top two rating categories the portfolio will experience a loss in market value which is not reflected in the liability and a portfolio manager would need to decide whether to sell a bond which no longer meets the original criteria. If the bond is sold, a loss relative to the liability will be experienced, increasing the ultimate cost of settlement. For example, at the end of 2011 many AA-rated bonds for financial institutions were already viewed as high risk and bond matching portfolios for accounting purposes “cherry picked” these bonds to produce relative high rates. In fact, at the end of 2011, the average AA bond yield was higher than the average single-A bond yield. Those higher risk bonds were downgraded in 2012 and exacerbated the large drop in discount rates between EOY 2011 and EOY 2012. Thus any portfolio invested in matching AA bonds in 2011 would have fallen substantially behind its liability target in 2012.
- Inflation sensitivity. Because there are no inflation-indexed corporate bonds, any part of a pension liability that is fully or partially sensitive to inflation could not be defeased with corporate bonds.
- Benefit provisions which can’t be matched. Benefit provisions such as guaranteed rates of interest, cash balance interest rate crediting, and even lump sum payments (which fix rates during a 12-month period) are not directly “defeaseable”.

Typically the total impact of these factors could be expected to be between 50-100 bps, depending on the size of the plan (which impacts the fee level) and how much impact from defaults and downgrades is anticipated. A real-world bond portfolio will include single-A and usually BBB bonds that will increase the yield on the portfolio and reduce the impact of bond availability, but also increase the potential for default risk. However, real world portfolios often include a mix of Treasury (often STRIPS) and corporate securities as well. Overall, the real world cost of settling a pension liability by investing in corporate bonds is probably about 10% higher than the cost of hypothetical AA or better portfolio. It is probably about 5% less than the cost of a hypothetical portfolio of Treasury securities.

For some plans, a true defeasement portfolio is much more complex than for traditional pension payments. For instance a defeasement portfolio for a cash balance plan (with a crediting rate equal to 30 year Treasury rates) would include the use of forward rates, the use of derivatives, and projecting the yield curve beyond 30 years to a much greater extent than for a typical pension plan (in order to develop the forward rates). COLA provisions with caps and floors also make the creation of a defeasement portfolio very challenging.

IRDM & UNIT CREDIT METHOD

It is preferable to base the IRDM on the traditional unit credit method since this provides information about benefit security and settlement which is relevant for most pension plans – the exception being some public plans which may not be allowed to settle based on accrued benefits. The disadvantage of using TUC for the IRDM is that it muddles the impact of the cost method with the impact of investment and assumption (discount rate) risk. A disclosure which would be valuable in all circumstances might look like the following:

a. Funding target (best estimate discount rate, EAN)	$5,000.00
b. Adjustment to market discount rate	$2,000.00
c. Adjustment to Unit Credit cost method	($800.00)
d. Market-sensitive solvency measure	$6,200.00
Investment risk ratio (b/a)	40%

Presumably, if actuaries felt like the TUC measure was misleading in the case when another cost method is being used for funding, they could identify the different pieces in a format similar to the display above.

AMORTIZATION METHOD

It may not be clear to all actuaries why the duration of the AAL is an important factor to consider with regard to the amortization method. It could be beneficial to expand on this, perhaps to include the size and remaining working lifetime for the active population as a consideration or to say "duration of the AAL or other measures of maturity of the plan population". A plan with a small active population (relative to the retired group) and/or an older active population should pay off deficits quickly. Any approach to funding and amortization which does not target full payment within the active employees working lifetime introduces material risk that benefits may not be paid as promised. Any such approach should be discouraged.

PREDICTABILITY OF COSTS

The goal of predictable costs may be better described along the lines of "maintaining the cost level and cost uncertainty within a range that is anticipated and manageable by the plan sponsor". The issue is that costs may become a source of financial stress for the plan sponsor. Small costs which are unpredictable won't present a problem beyond minor budgeting issues.

Comment #4 – 7-3-18 – 8:12 p.m.

To: The Actuarial Standards Board

From: Ken Steiner, FSA

Subject: Comments on ASOP No. 4 Revision

Date: July 3, 2018

I am a retired pension actuary. The comments below are submitted solely on my behalf. These comments relate primarily to Section 3.14, Amortization Method.

Background

Funding of public pension plans is a good news/bad news story. The good news is that the general actuarial pension plan funding process, involving periodic calculation of an actuarially determined contribution (ADC), is for the most part, a self-correcting process. If assumptions about the future are too optimistic, future ADCs will increase over time as they are determined in subsequent actuarial valuations. If assumptions about the future are too conservative, subsequent years' ADC's will decrease, all things being equal. The bad news is that this self-correcting process can be defeated (or unreasonably delayed) if:

1. the plan sponsor contributes less than the ADCs,
2. the cost of periodic benefit improvements is amortized over unreasonably long periods
3. overly optimistic assumptions are used and subsequent years' ADCs are developed by over-smoothing the resulting actuarial losses or increases in unfunded actuarial liability resulting from changes in assumptions,
4. overly optimistic assumptions are used and then are subsequently changed with the associated increase in Actuarial Accrued Liability amortized over an unreasonably long period.
5. Some combination of the items above

In "optimistic assumption/over-smoothing" situations, sponsor contribution stability is frequently stressed at the expense of participant security and "intergenerational equity." I believe that it is important for the revised standard to provide more definitive and stronger guidance to actuaries in Section 3.14 in order to achieve the intended balance referred to in Section 3.17 d.

Comments and Suggestions

As currently worded, I believe the guidance provided in Section 3.14 is unclear and insufficient. It should require that the gain/loss (or change in unfunded actuarial accrued liability associated with a change in assumption or method) since the previous valuation be calculated in each actuarial valuation and each such separately determined "gain/loss" or "assumption/method" amortization base" be fully amortized over a reasonable period in a reasonable manner, without regard to how other amortization bases may be amortized. Consistent with existing language in Section 4.1s, "the remaining balance to be amortized, the remaining amortization period, and the amortization payment included in the… actuarially determined contribution for each amortization base [should be disclosed in the valuation report containing a determination of the Reasonable Actuarially Determined Contribution under Section 3.20].

While the ASB may not want to prescribe specific “reasonable” periods for amortization of actuarial gains/loss bases or changes in assumptions/methods bases, I recommend the guidance suggest an amortization period no longer than the weighted average future expected lifetime of active plan participants (approximately the ratio of the actuarial present value of future salary divided by the current salary of active plan participants), or a period of 15 years, if greater.

The guidance should also require that amortization periods used for actuarial loss bases or increases in actuarial accrued liability from assumption/method change bases be no shorter than periods used to amortize actuarial gains or decreases in actuarial accrued liability from assumption/method changes. In addition, the method of amortization should generally be the same, or at least not result in slower recognition of actuarial losses/increases in actuarial liability resulting from assumption changes.

The actuary should be encouraged to use historical data for the purpose of establishing amortization bases for this purpose, but if such data does not exist or is not easily obtainable, the actuary should be permitted to apply this new requirement on a prospective basis.

While pension actuaries are accustomed to maintaining separate amortization bases for different sources of unfunded actuarial accrued liability, I would not necessarily have a problem with a reasonably designed alternative approach that focused on total accumulated gain/losses (assumption/method change) measured as a percentage of total AAL. Under this alternative, there could be no gain/loss amortization (recognition in current ADC) if total gain/losses fell inside a small corridor when measured as a percentage of the plan’s AAL, but amortization (percentage recognized in the current ADC) would increase incrementally as the total accumulated gain/loss increased as a percentage of UAAL.

Utilizing either the individual amortization base approach or the alternative increasing recognizing corridor approach based on total accumulated gain/losses, I believe it is important for Section 3.14 of the revised standard to provide guidance that does a better job of balancing plan sponsor desires for contribution stability with increased participant security and intergenerational equity.

Thank you for your consideration of these comments/suggestions.

BAY COUNTY EMPLOYEES' RETIREMENT SYSTEM
BAY COUNTY VOLUNTARY EMPLOYEES' BENEFICIARY ASSOCIATION
BAY COUNTY BUILDING
515 CENTER AVENUE
BAY CITY, MICHIGAN 48708-5128

July 10, 2018

Actuarial Standards Board
1850 M Street NW, Suite 300
Washington, DC 20036

To Whom It May Concern:

The Bay County Employees' Retirement System was established to provide retirement income to qualified employees and former employees. BCERS is over 100% funded and takes great care to follow the advice of our service providers to ensure that we can honor the benefits promised to our members. We understand that as a plan we must reevaluate our current assumptions and adopt new standards. We have recently completed an experience study spanning a 5 year period and followed the advice of our actuary to adopt all of the proposed assumptions. The Bay County Employees' Retirement System implores the Actuarial Standards Board to reconsider the proposed section 3.11 of ASOP 4. We believe that the Investment Risk Defeasement Measure will misrepresent the health of our plan and will negatively impact the system.

BCERS appreciates the Actuarial Standards Board's work to examine the current Actuarial Standards of Practice and ensure that pension plans and the public are provided with an accurate funding valuation. However, the inclusion of the Investment Risk Defeasement Measure will undoubtedly be used against the members of our plan and the public interest. Including in our funding valuation a calculation where the benefits are valued with a discount rate that reflects either U.S. Treasury yields or the rates at which pension obligations may be effectively settled will mislead anyone who is unfamiliar with a financial knowledge of pension systems. As a governmental plan the BCERS Board must present our funding valuation to the public and our members. Including the Investment Risk Defeasement Measure in our valuation will burden the Board with devoting time and resources to make sure that there is no confusion as to the valuation of assets in our plan and our ability to make current and future benefit payments.

Defined benefit pension plans have been under attack on the national level and also in our home state of Michigan. We have been called to action recently to stop Michigan lawmakers from passing blanket legislation that threatens to burden employers and penalize employees. The inclusion of the Investment Risk Defeasement Measure in our funding valuation would provide defined benefit plan opponents with a tool to validate their arguments. The Investment Defeasement Measure would portray our system as underfunded and unable to provide the benefits to our members. Not only will this cause unnecessary confusion for our members but also to legislatures who have been debating pension plan reform.

Thank you for considering The Bay County Employees' Retirement System's position on the proposed section 3.11 of ASOP 4. Again, we urge the Actuarial Standards Board to not require a standard of including the Investment Risk Defeasement Measure in our funding valuation.

Sincerely,

BAY COUNTY EMPLOYEES' RETIREMENT SYSTEM

Steven Gray

Steven Gray
Chairperson of Bay County Employees' Retirement System

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

To Whom It May Concern,

This email presents my comments on the proposed revision to Actuarial Standards of Practice 4 (ASOP 4). I emphasize that my comments are personal and do not necessarily represent the views of my employer or of any actuarial body of which I am a member. I am an Associate of the Society of Actuaries, An Enrolled Actuary, and a member of the American Academy of Actuaries.

I strongly urge the ASB to remove the word defeasement from ASOP 4, and I request that the ASB consider substituting Investment Risk Diminution Measure for Investment Risk Defeasement Measure for the following reason:

> A pension actuary may take a position based on his principles that "defeasement" (meaning nullification) is a word that is inappropriate for investment risk in a defined benefit pension plan unless that plan is terminated, and he may, in accordance with Section 3.2 a. of ASOP 4, word the purpose of the Investment Risk Defeasement Measure accordingly.[1,2] That actuary may do additional work that is not generally included in a funding valuation[3], and he may be at a disadvantage in terms of setting competitive prices for actuarial services compared to other pension actuaries who do not take that position. The exposure draft for ASOP 4 as currently written may diminish respect for the Actuarial Standards of Practice. An increasing number of pension actuaries may need to compromise their principles by rationalizing ways to avoid the position described above so that they may continue offering their services as pension actuaries.

I also request that the Actuarial Standards Board (ASB) consider (1) adding guidance about the purposes for the Investment Risk Diminution Measure, (2) adding a definition for the Investment Risk Diminution Measure to Section 2 and (3) amending Section 1.2 to clarify that the Investment Risk Diminution Measure is "an assignment of the value of plan obligations to time periods" and not an obligation related to "annuity pricing."

Thank you,

Michael Hunter

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[1] ASOP 4 provides no guidance with respect to the purposes of the Investment Risk Defeasement Measure. In addition, the Investment Risk Defeasement Measure is not defined in Section 2, nor has the scope of ASOP 4 been amended to indicate that the Investment Risk Defeasement Measure is "an assignment of the value of plan obligations to time periods" and not an obligation related to "annuity pricing", which is not included in the scope of ASOP 4.

[2] The purpose of the Investment Risk Defeasement Measure could be worded as follows: "…to communicate the equivalent of an obligation that, if matched in assets, could have allowed the plan sponsor to purchase annuity contracts for all plan participants as of the valuation date as part of a standard plan termination." This purpose is reasonably based on the definition of defeasance and on the reference in Section 3.11 to "[discount] rates at which the pension obligation can be effectively settled."

[3] The additional work may include the following: (1) evaluate and potentially use alternate actuarial assumptions in addition to the discount rates, (2) analyze and communicate information about the volatility of the measure, (3) provide a sensitivity analysis for the measure, and (4) communicate information about the plan's investments and how they differ from an investment portfolio associated with the discount rate(s) used for the measure.

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South Dakota Retirement System

July 19, 2018

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

comments@actuary.org

Members of the Actuarial Standards Board:

Thank you for the opportunity to comment on the Exposure Draft of proposed revisions to ASOP No. 4 Measuring Pension Obligations and Determining Pension Plan Costs or Contributions.

The South Dakota Retirement System (SDRS) is a government sponsored, cost-sharing, multiple-employer hybrid retirement plan covering almost all public employees in South Dakota. The undersigned have prepared this response on behalf of SDRS with input from others in our organization. Because SDRS is a public-sector pension plan, our focus is primarily on the impact of the proposed ASOP No. 4 revision on public-sector plans.

Investment Risk Defeasement Measure

Our comments primarily pertain to Section 3.11 of the proposed ASOP No. 4 revision, the Investment Risk Defeasement Measure (IRDM).

ASOP No. 1 is the introductory ASOP and Section 3 of ASOP No. 1 is titled “Purpose and Format of Actuarial Standards of Practice.” Section 3.1.4 in its entirety reads:

> 3.1.4
>
> The ASOPs are principles-based and do not attempt to dictate every step and decision in an actuarial assignment. Generally, ASOPs are not narrowly prescriptive and neither dictate a single approach nor mandate a particular outcome. Rather, ASOPs provide the actuary with an analytical framework for exercising professional judgment, and identify factors that the actuary typically should consider when rendering a particular type of actuarial service. The ASOPs allow for the actuary to use professional judgment when selecting methods and assumptions, conducting an analysis, and reaching a conclusion, and recognize that actuaries can reasonably reach different conclusions when faced with the same facts.

In addition, the Appendix of ASOP No. 1 features a section on “The Role and Scope of ASOPs” which includes the following statement:

> Because the ASOPs are not overly prescriptive and allow for disclosed deviations, the ASOP framework is designed to accommodate the actuary’s judgment in providing high-quality actuarial services and acting with integrity.

Therefore, the purpose, format, role and scope of the ASOPs:

1. Are principle-based and not narrowly prescriptive.
2. Provide the actuary with an analytical framework for exercising professional judgment, including the selection of methods and assumptions.
3. Identify relevant factors to consider.

The Investment Risk Defeasement Measure (IRDM) in Section 3.11 of the proposed revision to ASOP No. 4 conflicts with the ASOP No. 1 framework for actuarial standards and deviates from a clear focus on the purpose of the measurement as emphasized in recently revised or adopted ASOPs.

The proposed IRDM measure prescribes actuarial methods and assumptions regardless of plan circumstances, structure, or legal environment. The measure values accrued benefits using the unit credit actuarial cost method and discount rates matching yields for a hypothetical bond portfolio. If it is possible to freeze benefit accruals, and if it is possible to construct a bond portfolio exactly matching the expected payouts of the frozen benefits over several decades, then arguably the IRDM gives a theoretical measure of the assets required at the measurement date to eliminate investment risk for benefits already accrued. But because the IRDM is based on a different actuarial cost method than the funding valuation, includes only accrued and not projected benefits, and is based on different actuarial assumptions than the funding valuation, it is certainly not a measure of the investment risk, or the cost to defease the investment risk, inherent in ongoing plan funding.

The ostensible purpose of the proposed IRDM is an investment risk measure, even though a robust framework for identifying, assessing, and disclosing risk was recently adopted in ASOP No. 51. Consistent with the purpose, format, role and scope of ASOPs laid out in ASOP No. 1, ASOP No. 51 appropriately addresses identifying, assessing, and communicating plan funding risks, including investment risk and:

1. Lists investment risk as the first example of risks to be identified and assessed.
2. Presents an analytical framework for exercising professional judgment.
3. Provides guidance on the process, methods, and considerations to assess risk, all of which would actually be effective in assessing investment risk, unlike the proposed IRDM measure.

An effective investment risk assessment should consider the plan's actual asset allocation and its potential impact on future funding measurements when complying with ASOP No. 51. As an example, we have attached an investment risk assessment disclosure for SDRS that we intend to begin including in the annual valuation reports. Such a risk assessment provides meaningful and relevant plan funding information, as contrasted with the proposed IRDM measure.

Because the IRDM would be based on yields on a theoretical bond portfolio reflecting market rates at the measurement date, it would provide no meaningful funding trend information from year to year. Instead, it would produce results that may vary significantly from year to year, not based on the progress to date towards funding promised plan benefits including the actual investment performance of the plan, but based on bond market volatility. Such a measure is inconsistent with the purpose of a funding valuation – determining or evaluating the adequacy of plan contributions to support benefits. Furthermore, the proposed IRDM would be a required element of funding valuations regardless of whether a plan is considering or even legally able to cease plan accruals, and would prescribe assumptions and methods that may be entirely inappropriate or unreasonable for the funding of many plans.

The proposed IRDM mandates the discount rate and funding method to value the benefits accrued as of the measurement date. Other assumptions are those used in the funding valuation or "based on estimates inherent in market data, in accordance with ASOPs Nos. 27 and 35." But there may be no market data on other assumptions and the other assumptions used in the funding valuation may be wholly inappropriate in the context of liability defeasement. In addition, the use of other funding valuation assumptions for plans with risk-sharing or variable benefit features are likely to be inconsistent with the investment return of a theoretical bond portfolio. Adherence to Section 3.11 of the proposed revision to ASOP No. 4 may therefore conflict with adherence to the assumption consistency requirements of ASOP No. 27 Section 3.12 and ASOP No. 35 Section 3.7.

ASOP No. 51 Investment Risk Assessment Example

We agree with the PTF report that additional disclosure could avoid the potentially misleading practice of showing one traditional value of a plan's funded status or contribution requirements. We also agree that additional disclosure could provide important information about risk and encourage better understanding of funding requirements and affordable benefits.

We applaud the ASB for the work done developing ASOP No. 51. It provides the appropriate analytical framework for considering funding risks, including investment risk. ASOP No. 51 provides multiple methods for assessing risk that would truly measure risk, unlike the proposed IRDM measure. For example, scenario testing with a projection of funding results based on a range of future investment returns and liabilities calculated on a consistent basis would be an effective and realistic measure of investment risk.

ASOP No. 51 supports such an analysis. The attached examples for both SDRS and a model typical public-sector plan include a projection of funding results with liabilities measured on the same actuarial assumptions and investment returns modeled with three scenarios for SDRS and for a model typical public-sector plan:

1. The assumed annual net investment return,
2. The expected 25th percentile annual net investment return over a 15-year period, based on the assumed investment return and the expected standard deviation of the asset allocation, and
3. The expected 75th percentile annual net investment return over a 15-year period, based on the assumed investment return and the expected standard deviation of the asset allocation.

As would be expected under ASOP No. 51, the investment risk assessment example is adapted to the specifics of each plan. SDRS includes risk-sharing benefit features that makes our example disclosure somewhat more complex, but better reflects expected experience considering actual plan benefits, investment strategy, and governing statutes. As noted above, the proposed IRDM measure does not measure risk or permit the customization of the measure to reflect the actual benefit structure, circumstances, and environment of each plan as would be standard under the measures of ASOP No. 51.

These example projections would be consistent with the recently revised ASOP No. 51. They would also be consistent with the ASBs' recent focus on the "purpose of the measurement" since they accurately reflect the impact of investment return variability on projected funding measurements.

For SDRS, and for many public-sector plans, investment risk is by far the largest risk to adequate future funding and as such, has been the focus of our risk assessment example. But many plans are subject to multiple, simultaneous risks, some of which may be correlated and others not. The ASOP No. 51 framework supports the assessment of multiple simultaneous risks and allows modeling of the real-world impact of those risks. Conversely, the proposed IRDM calculates a theoretical measure of the cost to eliminate investment risk that is subject to volatile bond market fluctuations unrelated to actual plan experience.

Reasonable Actuarially Determined Contribution

Other than the proposed IRDM measure, we agree with most of the changes in the proposed revision to ASOP No. 4. We note the requirement to calculate and disclose a reasonable Actuarially Determined Contribution (ADC) in Section 3.20. We believe it is important that the Contribution Allocation Procedure that is defined in Section 2.8 and referenced in Section 3.20 continue to explicitly permit a range of values. For many public-sector pension plans, the ADC determined based on the Contribution Allocation Procedure is often viewed by sponsors, contributing entities, or other stakeholders as the one contribution requirement that will sufficiently fund plan benefits within a specified timeframe. Outside readers of plan information, including government officials and regulators, have interpreted the ADC as a maximum reasonable contribution. We therefore believe that the maintenance of a range of values in the Contribution Allocation Procedure used in the development of the ADC, is crucial for understanding the possible range of future plan funding requirements.

Section 2.8 of ASOP No. 4 allows the Contribution Allocation Procedure to be a range of values and cites an ERISA minimum required contribution and a maximum tax-deductible amount as an example. Enumerating additional examples of factors that would produce a Contribution Allocation Procedure range would be constructive. Additional factors could include:

1. Consideration of adverse deviation, in addition to any consideration given in specific assumptions.
2. Variable benefits that are supported by fixed, or limited, contributions.
3. Funding policy decisions that may vary based on funded status or economic conditions.

With more public-sector plans using variable benefit features combined with fixed funding rates, the consideration of a range of contribution requirements in the Contribution Allocation Procedure is even more important. An ADC for plans with fixed contribution rates may well be the fixed contribution rate if within a Contribution Allocation Procedure range determined independent of the fixed contribution rate.

Standard Setting Process

We are unable to comment on the proposed revisions to ASOP No. 4 without addressing the apparent departure from the typical standard setting process.

ASOPs Nos. 4, 27, and 35 were adopted in 2013 and 2014 after rounds of exposure drafts and comment opportunity. The background notes in the proposed revision to ASOP No. 4 indicates that actions to consider additional changes were initiated before the recent changes were fully implemented and that the ASB directed the Pension Committee to implement the suggestions of the Pension Task Force (PTF), a committee of four individuals, rather than to consider the suggestions in the context of the professional judgment of the pension professionals on the Pension Committee.

ASOP No. 51 was also finalized and adopted during this same time period, yet no requirement for the IRDM was included as a mandatory risk measure. Instead, the proposed IRDM appears to be closer to a market-based value of liability measure suggested in the PTF report.

In its justification for a market-based value of liabilities, the PTF report includes advancing the actuarial profession and "incorporating widely accepted and intellectually compelling arguments from other professionals" but specifically does not imply that the market-based liability measurement is "the one true answer." Unfortunately, publications and reports that have estimated and published market-based liability figures for plans often make that exact statement. Furthermore, the inclusion of the proposed IRDM measure as a required element of the plan's funding valuation implies such a measure is endorsed as an official plan or industry measure. Adopting the proposed revisions to ASOP No. 4 may force many public pension actuaries to choose whether to comply with the proposed IRDM measure requirement or to comply with Precept 8 of the Code of Professional Conduct requirement to take reasonable steps to ensure actuarial services are not used to mislead other parties.

This series of events and the apparent mischaracterization of a market-based liability measure as an investment risk measure raises serious questions about the transparency, consistency, and purpose of the proposed revisions.

Conclusion

For the reasons stated above, we ask that the Actuarial Standards Board remove the Investment Risk Defeasement Measure from the proposed revision of ASOP No. 4. ASOP No. 51 already provides a more appropriate and robust framework for identifying, assessing, and disclosing investment risk and its impact on future funding measurements.

The increasing maturity of public retirement plans, the movement towards flexible benefit designs, and the frequency of fixed or limited contribution rates require the consideration of a range of values in the Contribution Allocation Procedure and accordingly we agree that the development of the ADC should continue to not be prescriptive and consider these factors and others.

Thank you for the opportunity to address these issues on behalf of the South Dakota Retirement System. We would be more than willing to provide any additional information that may be helpful in your deliberations.

Sincerely,

Douglas J. Fiddler	R. Paul Schrader	Robert A. Wylie
Senior Actuary	Consultant/Retired Actuary	Executive Director

<u>June 30, 2017 Projected SDRS Funding Results</u>

Example Valuation Report Excerpt

The SDRS funded status and Actuarially Determined Employer Contributions (ADC) are based on numerous actuarial assumptions that have been selected based on the system's experience and future expectations, including the expected annual investment return of 6.5%. The basis for the 6.5% investment return assumption has been developed elsewhere in this report.

Table 2.5 illustrates the projected Fair Value Funded Ratio (FVFR) and ADC over the next five years assuming alternative investment returns on the fair value of assets. The projections are based on actuarial assumptions (other than investment returns), methods and plan provisions that are the same as reflected in this June 30, 2017 valuation, including plan provisions that vary automatically with the FVFR.

Three scenarios of projected results are shown assuming annual net investment returns equal to:

1. The expected 25th percentile annual investment return over a 15-year period, based on the assumed investment return of 6.5% and an assumed standard deviation of 15.4% (3.82%)
2. The annual investment return assumed in this June 30, 2017 valuation of 6.5%
3. The expected 75th percentile annual investment return over a 15-year period, based on the assumed investment return of 6.5% and an assumed standard deviation of 15.4% (9.18%)

Table 2.5 – June 30, 2017 Projected Funding Results

	Projected Investment Return					
	3.82%		6.50%		9.18%	
June 30,	Fair Value Funded Ratio	Actuarially Determined Employer Contribution	Fair Value Funded Ratio	Actuarially Determined Employer Contribution	Fair Value Funded Ratio	Actuarially Determined Employer Contribution
2017	100.1%	6.274%	100.1%	6.274%	100.1%	6.274%
2018	100.1%	6.274%	100.1%	6.274%	100.0%	6.274%
2019	100.7%	6.274%	100.3%	6.274%	101.6%	6.274%
2020	100.5%	6.274%	100.4%	6.274%	104.3%	6.274%
2021	100.7%	6.272%	100.1%	6.272%	107.2%	6.272%
2022	100.0%	6.271%	100.2%	6.271%	110.2%	6.271%

Table 2.5 results recognize the automatically adjusting features of SDRS. The COLA is the primary flexible feature of SDRS benefits and variations in the restricted maximum COLA are key to understanding the projected future funded ratios. Table 2.6 projects future baseline FVFRs and restricted maximum COLAs based on the same scenarios presented in Table 2.5.

Table 2.6 – June 30, 2017 Projected Baseline Fair Value Funded Ratio and Restricted Maximum COLA

	Projected Investment Return					
	3.82%		6.50%		9.18%	
June 30,	Baseline Fair Value Funded Ratio	Restricted Maximum COLA	Baseline Fair Value Funded Ratio	Restricted Maximum COLA	Baseline Fair Value Funded Ratio	Restricted Maximum COLA
2017	96.4%	1.89%	96.4%	1.89%	96.4%	1.89%
2018	94.1%	1.65%	96.5%	1.90%	99.0%	2.15%
2019	91.9%	1.35%	96.7%	1.90%	101.6%	None*
2020	89.8%	1.15%	96.9%	1.90%	104.3%	None*
2021	87.9%	0.90%	97.0%	1.95%	107.2%	None*
2022	86.1%	0.75%	97.2%	1.95%	110.2%	None*

*When the SDRS FVFR is 100% or greater under the baseline COLA assumption of 2.25%, no restricted maximum COLA is applicable and the SDRS COLA is equal to the increase in the CPI-W with a minimum of 0.5% and a maximum of 3.5%.

SDRS benefits will vary with system experience and both member and employer contributions are fixed. The risk of investment results less than anticipated under SDRS is borne by members because it results in reduced benefits. That risk is best illustrated by considering the likelihood of various investment returns based on the benchmark asset allocation of the SDRS trust fund over shorter time periods because benefits vary automatically as required, and additional benefit reductions will be recommended as required by statue if the variable benefits are not adequate to meet statutory requirements. The risk of benefit reductions is illustrated elsewhere in this report. Conversely, better than expected investment results provide the opportunity for increased benefits under Board of Trustees' policies.

SDRS' current FVFR as of June 30, 2017 is 100.1% based on the assumed investment return of 6.5% and a restricted maximum COLA of 1.89%. Future investment returns will vary from the expected 6.5% and future restricted maximum COLAs will vary as a result. Five years of annualized net investment returns of approximately 3.3% or less will exhaust the variability built into the SDRS COLA and, by statute, require a recommendation to the South Dakota Legislature for corrective actions (benefit reductions). Likewise, five years of annualized net investment returns of approximately 11.0% or more will satisfy the Board of Trustees' policy for benefit improvements and trigger consideration of a recommendation to the Legislature for a benefit increase subject to additional policy restrictions on type and timing of improvement.

Historical annual investment returns and inflation are shown in Table 2.7:

Table 2.7 – Historical Investment Returns and Inflation

Period Ending June 30, 2017	Annualized Net Investment Returns	Annualized Inflation
1 Year	13.84%	1.50%
5 Years	10.96%	1.11%
10 Years	6.14%	1.59%
15 Years	8.49%	2.06%
20 Years	7.97%	2.11%

June 30, 2017 Projected Model Plan Funding Results
Example Valuation Report Excerpt

The Model Plan funded status and Actuarially Determined Employer Contributions (ADC) are based on numerous actuarial assumptions that have been selected based on the system's experience and future expectations, including the expected annual investment return of 7.5%. The basis for the 7.5% investment return assumption has been developed elsewhere in this report.

Table 2.5 illustrates the projected Fair Value Funded Ratio (FVFR) and ADC over the next five years assuming alternative investment returns on the fair value of assets. The projections are based on actuarial assumptions (other than investment returns), methods and plan provisions that are the same as reflected in this June 30, 2017 valuation, including plan provisions that vary automatically with the FVFR.

Three scenarios of projected results are shown assuming annual net investment returns equal to:

1. The expected 25th percentile annual investment return over a 15-year period, based on the assumed investment return of 7.5% and an assumed standard deviation of 15.4% (4.80%)
2. The annual investment return assumed in this June 30, 2017 valuation of 7.5%
3. The expected 75th percentile annual investment return over a 15-year period, based on the assumed investment return of 7.5% and an assumed standard deviation of 15.4% (10.20%)

Table 2.5 – June 30, 2017 Projected Funding Results

	Projected Investment Return					
	4.80%		7.50%		10.20%	
June 30,	Fair Value Funded Ratio	Actuarially Determined Employer Contribution	Fair Value Funded Ratio	Actuarially Determined Employer Contribution	Fair Value Funded Ratio	Actuarially Determined Employer Contribution
2017	74.3%	18.887%	74.3%	18.887%	74.3%	18.887%
2018	72.9%	19.097%	74.8%	18.903%	76.8%	18.708%
2019	71.6%	19.560%	75.4%	18.919%	79.4%	18.267%
2020	70.3%	20.263%	76.0%	18.936%	82.1%	17.564%
2021	69.0%	21.193%	76.7%	18.954%	84.9%	16.595%
2022	67.9%	22.342%	77.4%	18.974%	87.8%	15.357%

The risk of investment results less than or greater than the actuarial assumption anticipated will impact future FVFRs and ADCs. Model Plan's current FVFR as of June 30, 2017 is 74.3% based on the assumed investment return of 7.5%. Future investment returns less than the actuarial assumption will reduce future FVFRs and increase future ADCs. Conversely, future investment returns greater than the actuarial assumption will increase future FVFRs and decrease future ADCs.

Historical annual investment returns and inflation are shown in Table 2.7:

Table 2.7 – Historical Investment Returns and Inflation

Period Ending June 30, 2017	Annualized Net Investment Returns	Annualized Inflation
1 Year	12.5%	1.50%
5 Years	8.9%	1.11%
10 Years	5.3%	1.59%
15 Years	7.3%	2.06%
20 Years	7.0%	2.11%

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July 19, 2018

Via e-mail comments@actuary.org

Actuarial Standards Board
1850 M Street, NW, Suite 300
Washington, DC, 20036

Re: Comments on exposure drafts for Actuarial Standards of Practice (ASOPs) 4, 27 and 35

Dear Members of the Actuarial Standards Board (ASB) and the Pension Committee of the ASB

The Society of Actuaries (SOA) Board of Directors submits these comments to the exposure drafts of ASOPs 4 (*Measuring Pension Obligations and Determining Pension Costs or Contributions)*, 27 (*Selection of Economic Assumptions for Measuring Pension Obligations)*, and 35 (*Selection of Demographic and Other Noneconomic Assumptions for Measuring Pension* Obligations). The SOA Board thanks the ASB and the Pension Committee of the ASB (Pension Committee) for their work in reflecting the recommendations of the *Report of the Pension Task Force of the Actuarial Standards Board*, dated February 29, 2016 in the exposure drafts for ASOPs 4, 27 and 35. The Pension Task Force report represented a significant amount of time spent by the ASB listening to the pension community and reflecting on the role of pension standards. It is heartening to see that work reflected in the exposure drafts of ASOPs 4, 27 and 35. The SOA Board urges the Pension Committee to substantively maintain these changes to these ASOPs.

The SOA Board acknowledges the importance of the newly defined Investment Risk Defeasement Measure disclosure for funding valuation reports (ASOP 4 Exposure Draft, section 3.11). The Pension Task Force report cited the importance of introducing a required market-based measure to provide clarity and context to funding values, provide information about risk not found in other measures, and incorporate into actuarial science the best practices of other professions. The Investment Risk Defeasement Measure provides important information to assess the degree of risk in a plan's funding and investment policy that, when accompanied by an actuarial report that provides context for its meaning, improves pension plan sustainability. The SOA Board recommends this measure not be removed or meaningfully changed as ASOP 4 is revised, including any changes that would allow an actuary or plan sponsor to opt out of its calculation.

Sincerely,

M. Lombardi

Mike Lombardi
President, Society of Actuaries

Comment #9 – 7/20/18 – 2:35 p.m.

Comments on Proposed Revision of ASOP No. 4

From: Patrick Kinlaw, FSA, EA, MAAA and Sam Watts
To: Actuarial Standards Board (ASB)
Date: July 20, 2018

Thank you for the opportunity to comment on the proposed revision of ASOP No. 4. Patrick Kinlaw is an actuary practicing in-house at the North Carolina Retirement Systems, and has also worked in private-sector consulting. Sam Watts is a policy director at the North Carolina Retirement Systems. These comments are our own and do not reflect the views of any governmental entity, organization, or company.

The comments pertain to Section 3.11 ("Investment Risk Defeasement Measure") and Section 3.16 ("Output Smoothing Method").

Section 3.11, "Investment Risk Defeasement Measure"

Compared to actuarial practice prior to ASOP No. 51, it would be a step forward for public retirement systems' annual funding valuation reports to include a liability measure discounted using high-quality fixed income yields. It remains to be seen whether it is a step forward in light of ASOP No. 51.

While the measure has various potential uses to public systems, including improved funded status comparability across systems, its primary use is to illustrate the reliance of the valuation liability measurement on investment risk. The new measure, when compared to the valuation liability, illustrates the present value that the valuation assumes will be produced by investment risk-taking. It might become clearer that, to the extent returns are not delivered by investment risk-taking relative to the lower-risk benchmark, this present value must be funded by plan members, employers, or the public. This might lead to better-informed decisions.

The measure does not accurately indicate the cost of eliminating investment risk – even where such risk can be eliminated. It is better understood as a measure of the retirement system's reliance on investment risk, one that incorporates market information more immediately than the valuation liability does. This may underscore a naming problem in the Investment Risk Defeasement Measure, but it also may be more than a naming problem. In terms of modeling and communication, an unfavorable long-term investment experience scenario (a potentially valuable aspect to this disclosure for public retirement systems) might differ from an asset allocation scenario estimating the effect of a hypothetical change to 100% high-quality fixed income investments (less valuable for public systems). If the purpose is the former, then the nature of the calculation might lead the actuary to select different economic or demographic assumptions under Section 3.11(d). The actuary might also feel that a different projection or measurement, to be disclosed pursuant to ASOP No. 51, is a clearer illustration of the same underlying risk issue.

Public-system actuaries might reasonably be concerned about the potential selective highlighting of the new measure by policy advocates unconcerned with actuarial professional standards. The risk of misuse, beyond the actuary's control, should be weighed against whatever disclosure benefits the ASB perceives, incremental to benefits already implemented through ASOP No. 51. The ASB might consider further guidance as to how public-system actuaries may make the disclosure while taking "reasonable steps" to avoid its misuse (Code of Professional Conduct, Precept 8).

Here are some further practical observations regarding Section 3.11:

(1) **Possible Unintended Consequence:** There will be times in the future, just as in the past, when market fluctuations or sustained conditions will cause the Section 3.11 measure to be less than a retirement system's assets or its valuation liability. Such conditions, though far from current reality, should be considered in principles-based guidance. Using North Carolina as an example, for more than 30 consecutive years from the 1960s through the 1990s, the yield on long-term Treasury securities exceeded the long-term investment return assumption. As recently as 2009, long-term, high-quality fixed income yield indices during certain months exceeded the long-term investment return assumption. The use of the unit credit cost method would likely decrease the Section 3.11 measure further relative to the valuation liability. If the Investment Risk Defeasement Measure is less than current plan assets, stakeholders might conclude wrongly that the actuary is recommending action relative to asset allocation. They might conclude that such action would reduce the valuation liability when, in fact, it might increase it. If the Investment Risk Defeasement Measure is less than the valuation liability, stakeholders might conclude wrongly that the valuation liability is overstated. We might see unintended consequences such as entities misusing a temporarily low Investment Risk Defeasement Measure to advocate for higher rate-of-return assumptions, contribution holidays, or benefit increases without commensurate funding.

(2) **Fiscal Notes:** It is not entirely clear whether the definition of "Funding Valuation" in Section 2.12 is meant to include fiscal notes, whereby public-system actuaries inform governing bodies about the cost of proposed legislative changes. If so, additional guidance may be needed. For example, the recipient of a fiscal note may need to have a clear "single answer" for use in public budgets, comparison to estimates by other actuaries (or non-actuaries), or other purposes.

(3) **Bond Disclosures and Other Statements:** Although the measure is intended only for funding valuation purposes, its disclosure would require governments to consider whether or how to address it in bond offering statements, financial reporting footnotes, or other public materials. Actuaries will not always be in a position to inform or control these decisions.

(4) **Similar Measures Already Disclosed:** Some public systems may already disclose a measure like the Section 3.11 measure. For example, as required by state law, the annual funding valuation reports for the North Carolina Retirement Systems disclose a liability measure discounted using the yield on 30-year U.S. Treasury securities. The proposed revision appears to require a third measure, or a change in statute to conform the existing measure to ASOP No. 4.

(5) **Actuarial Cost Method:** Section 3.11(b) would require the new measure to be determined using the unit credit (UC) actuarial cost method. The ASB might consider whether the guidance could permit use of the entry age normal, level percent of pay (EAN) method. Public sponsors must use EAN for financial reporting. Many use EAN for funding purposes. Certain publications from the actuarial community have expressed a preference for EAN over UC for public-system funding. Moreover, a public-system actuary may believe EAN is more appropriate, for instance if benefit accruals related to future service are constitutionally protected.

(6) **Treasury Yield Curve vs. Single Rate:** Option 1 under Section 3.11(c) allows the measure to be determined by discounting at Treasury yields. The general language under Section 3.11(c), regarding "a hypothetical bond portfolio whose cash flows reasonably match the pattern of benefits expected to be paid in the future", implies use of a full Treasury yield curve. The ASB might consider whether this option could be simplified without meaningful loss of information by permitting use of a single, publicly transparent discount rate such as the 30-year Treasury yield.

Section 3.16, "Output Smoothing Method"

Guidance in this area is appreciated. As with the prior section, here are a few practical observations:

(7) **Multiple Output Smoothing Methods:** The contribution allocation procedure may include different types of output smoothing methods simultaneously. For example, while the effect of an assumption change is being phased into the calculation of the actuarially determined contribution, there may be a funding policy that provides for a minimum contribution level at least equal to (but sometimes exceeding) the actuarially determined contribution. The actuary may feel the existence of the funding policy is relevant to the reasonableness of phasing in the effect of the assumption change. It might be helpful to clarify whether, in evaluating if the relationship between the smoothed contribution and the actuarially determined contribution is reasonable, the actuary may take into account the combined effect of all operative output smoothing methods.

(8) **Maintaining Funding Discipline:** An output smoothing method may have the advantage of encouraging adherence to making a contribution that is at least related to the actuarially determined contribution. The output smoothing method may provide a viable path for the sponsor to implement recommended valuation updates without abandoning the funding policy. The guidance might address whether the anticipated actual contributions to the system, as opposed to those indicated by the contribution allocation procedure, are a relevant consideration. Although ASOP No. 51 states specifically that the actuary need not consider "the ability or willingness of the plan sponsor or other contributing entity to make contributions to the plan when due", in the context of an output smoothing method the conclusion might be different.

(9) **Clarification of "Systematically":** Section 3.16(c) states that in order for the output smoothing method to be reasonable, it should not be "expected to systematically produce contributions less than the actuarially determined contribution." The word "systematically" in this context is clear if there will be many observations over many periods, some greater and some less than an expectation (for example, with an asset smoothing method or amortization method). It seems less clear for an output smoothing method that is implemented for a limited time period, or to phase in the recognition of a particular change.

(10) **Mid-Course Corrections During Smoothing Period:** Conditions may change while the effect of an assumption change is being phased in over multiple measurements. Such changes may necessitate further revision of the assumption during the smoothing period. If, for example, the effect of a change in the investment return assumption is phased in, the asset allocation or capital market assumptions may change materially during the smoothing period. The proposed revision appears to afford the actuary some judgment in this situation, to recommend an adjustment within the guidance of Section 3.16. This seems appropriate.

Thank you for considering these comments. You are welcome to contact us with questions.

Comment #10 – 7/20/18 – 3:16 p.m.

Comments on Exposure Draft to Proposed Revision of ASOP No. 4

I am submitting these comments in regards to the exposure draft of ASOP No. 4, approved by the ASB in March 2018. These comments are being submitted on my own behalf, and not on behalf of my employer.

Section 3.11 Investment Risk Defeasement Measure – adding another calculation of the obligation measure to the funding valuation reports is at best confusing and at worst misleading to the potential audience of the report. Accordingly, I have grave concern that adding such a measure could result in the actuary violating Precept 8 of the actuarial code of conduct. This Precept states the actuary shall take reasonable steps to ensure that his services are not used to mislead other parties. Concern exists on whether best efforts to clearly present explanations and limitations on utilization of such information will prevent these measures of liabilities from being misinterpreted to other parties as the "true cost" of benefits.

Further utility of such a measure is debatable. For example, for pension plans that are traditionally invested (including meaningful equity allocations), a liability based on a risk free discount rate is of little value. It is unlikely such a measure would be used in decision-making for managing the plan. It may, however, result in wasting of resources to calculate, disclose and explain such a measure. In addition, such a measure could cause unmerited concerns and even panic as the measure could easily be misused by those either unknowledgeable on such matters or with their own political agendas.

If this section is retained, the term investment risk defeasement measure should be added and defined in Section 2, to aid in user. This concept of investment risk defeasement for an ongoing plan with a long-term life ahead of it, is a concept many will find extremely confusing and of little value. In my practice, I'm not looking forward to having to explain why we need to calculate and disclosure this measure nor am I confident I will be able to convince my clients that this addition is helpful to them. For many pension plans, there already exists obligation measures based on a range of discount rates (for funding, accounting and PBGC purposes, for example), so requiring this additional measure is not necessary and in many cases not helpful.

Therefore, I strongly urge the ASB to remove this Section 3.11 and the investment risk defeasement measure from the ASOP's.

Respectfully Submitted,

Glen Gahan

To: Actuarial Standards Board
From: Edward Bartholomew
Gordon Latter, FSA, FCIA
David G. Pitts, FSA
Larry Pollack, FSA, MAAA, EA
Date: July 23, 2018
Re: Comments on ASOP No. 4 Exposure Draft (March 2018)

We offer these comments in a personal capacity, informed by our professional experience, but not on behalf of any employer or organization.

We enthusiastically commend the ASB for the proposed revisions to ASOP No. 4. While the revisions do not go as far we might have hoped – which would be to make actuarial standards even more consistent with the basic principles of finance in its treatment of valuation and risk – the revisions proposed are an important step in the right direction.

Requiring the calculation and disclosure of an Investment Risk Defeasement Measure (IRDM) is a significant advance for pension actuarial practice, especially for cases where no market-based liability value is otherwise disclosed. While prescriptive, this requirement is highly principled – the two are not contradictory – and important in order for the profession to maintain respect among fellow finance practitioners. If the actuarial profession does not step forward with genuine standards, we believe economists and the accounting profession will continue filling the vacuum, and actuaries risk losing stature as a profession.[1]

As noted in the 2014 SOA Blue-Ribbon Panel Report, the difference between an IRDM pension liability and one based on expected asset returns will reveal how much sponsors are relying on realization of highly-uncertain risk premiums, compounded over decades, to fund long-dated pension promises.[2] And the difference between an IRDM pension liability and plan assets will reveal the additional cost to fully collateralize and defease the pension already earned.[3] This is meaningful even for plans that cannot be terminated, as it indicates the value of the uncollateralized debt of the plan sponsor for providing the promised secure benefit.

Listed below are a few modest recommendations for making ASOP No. 4 even better – an extra half step in the right direction:

- Drop the safe harbor of using AA bond yields as discount rates for IRDM calculations (3.11)
- Require calculation and disclosure of Normal Cost corresponding to the IRDM (3.11)
- Require disclosure of undiscounted cash flows and discount rates used to calculate both the IRDM obligation and the corresponding Normal Cost (3.11)
- Require that each year's annual amortization payments must actually amortize (reduce) the unfunded liability (3.14)

[1] See "Where are The Screaming Actuaries?" by Jeremy Gold: https://www.forbes.com/sites/pensionresearchcouncil/2015/11/20/where-are-the-screaming-actuaries/#440121e127d8
[2] Approximately, depending on the actuarial cost method use for expected-return calculations
[3] I.e., benefits accrued for past service

- Specify that an unsmoothed actuarially determined contribution (ADC) also be disclosed so that application of the reasonableness standard may be judged (3.16)
- Specify that the actuary should opine on the reasonableness of critical assumptions and methods even when those assumptions are prescribed by the plan sponsor (“by law” or otherwise) (3.20)

The addition of all or any of the above recommendations would make ASOP No. 4 even more consistent with the basic principles of finance in its treatment of valuation and risk and are logical extensions of the important changes already proposed. Specific language and rationale for each is given in the Appendix.

Appendix: Language and rationale for recommendations

<u>3.11: Investment Risk Defeasement Measure (IRDM)</u>

We strongly endorse the proposed addition of this new section, but suggest three changes:

1. Drop the safe harbor of using AA bond yields as discount rates for IRDM calculations by striking from the end of c.2. the sentence "The actuary may use yields of fixed-income debt securities that receive one of the two highest ratings given by a recognized ratings agency"

   Rationale:

   The sentence we propose to drop is inconsistent with the stated purpose of the IRDM, which is "to reflect the cost of effectively defeasing the investment risk of the plan."

   Since AA bonds are not default-risk free, funding a pension plan with such bonds does not eliminate (defease) investment risk. Over time, particularly over the decades that a pension promise extends, some AA bonds will suffer credit losses – either from downgrade and sale, or from default. Spot yields derived from AA bonds represent maximum returns, assuming no credit losses, not what would be realized in a downside case, or even the expected one.

   Although an insurance company assuming a pension liability (in a risk transfer transaction) might well use AA bonds as collateral, that's not the full story. The insurance company also would need to reserve for expected credit losses on these bonds and would need to hold capital to absorb unexpected investment losses (as well as unexpected longevity losses). These additional costs would be included in the settlement rate. We think the first part of c.2. ("rates at which the pension obligation can be effectively settled") covers this case.

   If such a settlement rate can't be determined, then using U.S. Treasury yields (as in c.1.) to represent default-risk free yields is appropriate. Yields on interest rate swaps based on daily collateral posting, often comparable to Treasury yields, would also be appropriate.

2. Require calculation and disclosure of Normal Cost corresponding to the IRDM by adding an unenumerated paragraph below the enumerated item (d):

   > In addition, the actuary should calculate and disclose the Normal Cost corresponding to the above calculated IRDM obligation, using a consistent set of assumptions.

   Rationale:

   The reason for having an IRDM measure of the pension liability is not only that it reflects an estimate of where the pension liability could be settled in current market conditions. It also reflects the funding required to not expose the promised pension payments to discretionary additional risk from investments. As noted in the SOA Blue Ribbon Panel Report, the IRDM is the cost of securing the promise (from investment risk) and to make transparent that the additional value claimed by assuming a return on a risky investment portfolio is not guaranteed and subject to the performance of that portfolio as expected.

   The same argument applies to Normal Cost. An IRDM Normal Cost represents the cost of the benefit earned during a year, and the amount which must be set aside to fund it without reliance on performance of a risky investment portfolio. It represents the best measure of an often important and otherwise obscure component of annual compensation, which should be of interest to the intended users of most actuarial work products.

3. Require disclosure of undiscounted cash flows and discount rates used to calculate both the IRDM obligation and corresponding Normal Cost, by adding this paragraph at the end:

   Finally, the actuary should disclose undiscounted annual cash flows and discount rates used to calculate both the IRDM obligation and Normal Cost.

This cash flow and rates disclosure should be included in the actuarial report, available to any readers of that report, and publicly disclosed or not per the plan sponsor's normal practice.

Rationale:

As is well known, those with an economic interest in the financial health of pensions, particularly public pensions, extend well beyond the narrowly defined "Intended Users" (ASOP No. 41). Stakeholders include plan beneficiaries and sponsor bondholders, who are at risk if a pension plan fails. And for public pensions, stakeholders also include current and future employees, recipients of government services, and taxpayers, who will be called upon to make up any financial shortfalls if required to make good on pension promises. Lacking official numbers generated by the plan actuary, who is in the best position to provide them, academic and industry analysts are estimating cash flows as well as they can. It would be better for all interested in accurate analysis if official actuarial cash flow projections were disclosed.

<u>3.14: Amortization method</u>

Change the "or" to "and" in the top sentence, so that it would now read:

> ... the actuary should select an **amortization method** that produces amortization payments that exceed nominal interest on the unfunded **actuarial accrued liability** and that satisfy the following conditions

In addition, drop condition (i) and renumber the remaining conditions.

Rationale: As written (with "or" instead of "and" as proposed) and including condition (i), the section allows the calculated amortization to be negative (an "anti-amortization"). This means the unfunded liability would be increasing, rather than decreasing as it should.

A superior approach would modify this section to require a simple straight-line amortization of the unfunded liability over the period selected. The unfunded liability is related to past service with no logical connection to future payroll. For this reason, there is no reason why the amortization method should be based on the assumed level or growth of future payroll.

<u>3.16: Output smoothing method</u>

Add "which should also be disclosed" at end of the first sentence, so that it would now read:

> ... the actuary should select an **output smoothing method** that results in a reasonable relationship between the smoothed contribution and the **actuarially determined contribution** without output smoothing, which should also be disclosed.

Rationale: The only purpose for output smoothing is to give sponsors additional time to adjust to large changes in the actuarially determined contribution without overly compromising the long-term security of the pension promise. This section requires “a reasonable relationship” between the smoothed and unsmoothed ADC, and gives three criteria (a, b, and c) for determining reasonableness. Unsmoothed ADC should also be disclosed so that application of the reasonableness standard may be judged by all stakeholders. Also, the gap between the two reveals the likely change in cash contributions over the next few years if conditions don’t change.

3.20: Reasonable Actuarial Determined Contribution (ADC)

Add “federal” before “law” in first sentence so that it would now read:

> If the actuary is performing a **funding valuation** that does not include a **prescribed assumption or method set by federal law, ...**

In our view, the actuary should opine on the reasonableness of critical assumptions and methods even when those assumptions are prescribed by a state or local plan sponsor (“by law” or otherwise).

Cavanaugh Macdonald
CONSULTING, LLC
The experience and dedication you deserve

July 23, 2018

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

RE: Proposed Revisions to ASOP 4

To the Members of the Actuarial Standards Board:

Cavanaugh Macdonald Consulting, LLC thanks the Actuarial Standards Board for this opportunity to comment on the proposed revisions to ASOP 4. We recognize that these revisions are rooted, as noted in the background sections of these three documents, in the context of a perceived need for additional guidance for public retirement plans. As a leader in providing actuarial consulting services to state and local government pension plans, we have expended tremendous effort over the years working toward educating boards, staff, and sponsors about appropriately funding these retirement plans, and from this experience we have some observations that we believe may be of value in helping to shape ASOPs that can best advance professional practice.

Prescriptive or Principle-Based?

Before dealing with some specific items in the proposed revisions, we believe there are two broad issues that should be addressed. The first of these is to note that many of the proposed changes for ASOP 4 are somewhat prescriptive, rather than being primarily principle-based. Generally, we actuaries have prided ourselves in being professionals and being able to exercise appropriate judgment in applying the core principles of our profession. We have made allowances for complying with applicable laws and regulations, or in assisting the accounting profession, but we have not wavered from the ideal of conducting our work as professionals following these core principals.

The challenge in moving to a more prescriptive model in ASOP 4 is that there are now significantly more details that must be provided. No longer can the ASOP language call on the actuary to consider a course of action – now it must describe that course of action in a way that can fit all situations. We note that for corporate pension plans guided by ERISA, there are hundreds of pages of specific requirements so that the actuary can carry out the required tasks. The proposed ASOPs are much shorter, of course, but that comes at the expense of being sufficiently prescriptive for all possible cases. We have identified a number of issues arising from real public retirement plans in which the proposed prescriptive ASOP language may be inadequate to provide complete guidance. If the underlying prescriptive requirement is not based on a

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principle, it becomes very difficult, and perhaps impossible, to simply use professional judgment to fill in the missing steps. Our point is that in order to be prescriptive and handle the wide range of real-world practice, it may well take hundreds of pages rather than just a few paragraphs to provide adequate guidance.

Further, ERISA does not require an actuary to be a professional, but instead calls for an actuary to carefully follow required steps. The various actuarial organizations in the United States have certainly encouraged practicing pension actuaries to join with them in acting as professionals following principles, and significant numbers have. Nonetheless, an Enrolled Actuary can legally practice on ERISA plans without needing to join those of us who seek to act as professionals – because the emphasis has been shifted from principle to prescription. Most public retirement systems currently require that their actuary be a member of one of the actuarial organizations that subscribe to the Code of Professional Conduct and the Actuarial Standards of Practice, ensuring that they have someone who acts in a professional capacity. Some, however, accept the Enrolled Actuary designation alone as sufficient. If the ASOPs for public plans become more prescriptive, at some point there may be less perceived need for professionals and systems may opt to engage Enrolled Actuaries without any other designation – or even non-actuaries – who can calculate the numbers they need without including the additional ASOP-compliance information they don't need or want, reducing the influence the profession has in this area. Principles require a professional, prescriptions require a technician.

Limited Application

A second broad observation is that much of the new material in the proposed ASOP 4 revision will not apply to the majority of pension plans. Section 3.20 does not apply when there is a prescribed assumption or method set by law, thereby excluding ERISA plans. Likewise, sections 3.14, 3.16, and 3.17 will not be applicable for ERISA plans because these methods are selected via federal laws and regulations. Of course, ERISA valuations performed by individuals who are only Enrolled Actuaries are already exempt from complying with any ASOPs. Another category of plans to which many of these new provisions would not seem to apply are unfunded plans. Because there is no intent to fund them formally, there would not technically be a funding valuation or the need for cost allocation procedures. Thus, many of these new sections really only apply to funded church and public plans.

At first glance, this may appear reasonable, under the presumption that if there are not already requirements for determining funding requirements, an actuary should follow reasonable procedures in setting these. Of course, we believe that the current ASOP 4 actually does contain such guidance already. Moreover, many public plans have controlling legislation that dictates much of what an actuary may do (including specifying in statute the service-based salary increase assumption in one case we are familiar with), but because these rules are set by the states that established the retirement systems, the ASOP's prescribed assumptions and methods exception does not apply.

Effectively, the ASOPs have set up a system whereby federally-set standards, some of which may have been legislated as a matter of delaying pension contributions to increase current tax revenues, are being presumed to be sufficient, while similar standards passed by state legislatures are deemed otherwise. It is not clear why the ASB should anticipate that officials elected to national offices will write legislation that is superior to that written by officials elected to state offices, especially since it was the same voters who elected both. Nonetheless, ERISA plans – which make up the majority of pension plans - are being exempted from significant portions of these new proposed ASOP changes, while public plans are not. We recognize there are some high-profile public plans where elected officials have chosen to delay funding, perhaps even against the advice of the systems' actuaries, but we also are aware that the PBGC has concerns about future finances, suggesting that the funding methods that are mandated for ERISA plans may have weaknesses as well. Excluding plans from the ASOP proposals solely because of the type of legislative body writing the rules does not make sense.

(As an aside, we recognize that some may object that state legislators cannot objectively write funding rules for plans they establish, control, and fund. However, the plan provisions, the funding requirements, and significant information about the operations and funding progress of these systems are readily available to the public. If the legislators are not behaving responsibly in the eyes of the public, the public will ultimately vote them out of office and select new legislators. If we feel that we need these actuarial standards because publicly-elected officials cannot be trusted, we are effectively claiming that we as actuaries know public policy better than the public. This seems to be arrogant and well outside our scope of expertise.)

Section 3.11

We next wish to address some specific issues where we believe the proposed revisions should be adjusted. First, we note that Section 3.11 requires that an actuary "calculate and disclose an obligation measure of effectively defeasing the investment risk" when performing a funding valuation. There are then some prescriptive elements of this calculation listed, including the valuing of benefits accrued as of the measurement date, the cost method, and a discount rate to be selected from one of two specific sources. As already discussed, this degree of specificity in this ASOP is in stark contrast with other ASOP language that frequently has terms such as "should consider" or "must consider". As we discuss in the following paragraph, the prescriptive, inflexible nature of this requirement creates some situations that are not clear, but without the apparent ability of the actuary to apply judgment.

Many public plans have adopted benefit provisions that mitigate the employer risk by adjusting the member benefits based on such measures as asset performance or plan funded ratio. A common example is a COLA or 13th check that is payable when the plan reaches a certain funding threshold. Another example is the use of a variable interest crediting rate in cash balance plans which is tied to recent investment returns. In both of these examples, the benefits are based, to some degree, on actual asset performance. If investment risk is eliminated by purchasing Treasuries, the expected return will be significantly lower, thereby reducing benefits. The proposed language for the investment risk defeasement cost is not clear as to how to proceed. Should the actuary assume that the benefits will not be reduced (simply changing the discount rate in a computer program) leading to a model which has inconsistent assumptions? Or should the actuary reduce the projected benefit payments, thereby leading to a calculated risk defeasement measure that actually contains a combination of investment risk reduction and benefit cuts? Professional judgment does not work well in this situation since the calculation is being performed by prescription rather than by principle. Either approach seems to run afoul of other actuarial principles – we either build an inconsistent model or we improperly identify a measure. This is not simply a technical issue to be addressed – there will be other variants and odd situations that will arise, requiring more and more technical modifications. It is rarely possible to be partly prescriptive.

Further, the described goal of this measure is to find the cost to "effectively" defease the investment risk. However, the discount rates described in 3.11.c are related to methods that are not capable of actually defeasing the investment risk. A simple illustration will suffice to demonstrate this: Suppose that we as very wise actuaries had decided to implement this strategy in 1980. We would have worked with a plan sponsor to purchase bonds that very nicely lined up with projected cash flows for the next 30 years, and then purchased some 30-year Treasuries with the coupons removed that we intended to reinvest in 2010 to cover the remaining 40-60 years of payments that would still be due. However, in 2010, interest rates were much lower and so we would have found that we did not have enough money to make the benefit payments. The risk was not "effectively" defeased because some (substantial) risk remained. Of course, we all knew in 1980 that interest rates were high and that such levels were not likely to continue. We feel much more confident in 2018 buying bonds to defease the risk, because rates are not likely to be much lower in 2048 than they are now. But, if rates are higher in 2048 (even if still below historic averages), we would have more money than was needed. Thus, we still have risk – if we set aside too much money, we gave up some other use of that money in the meantime. If it were possible to buy options to purchase Treasuries 30 years and 60 years from now, then it would be possible to say investment risk can be "effectively" defeased. Otherwise, we are not accomplishing the stated goal of this section, but are instead feeling foolishly smug about our capabilities to predict interest rates well past our lifetimes.

We also note that while the goal of this disclosure calls for defeasing investment risk, one of the options (3.11.c.2) is to determine the cost of settling pension obligation, thereby eliminating all risks. While investment risk is usually the largest, there is an inconsistency between the stated intent and the method to measure it. If this method is allowed, we suggest that the actuary be further required to disclose which risks are being eliminated so that users will not be misled. Quantifying the cost of eliminating risks may indeed be valuable (and certainly is something actuaries will be considering under ASOP 51), so it is not clear why only one of those risks be identified in ASOP 4.

We do appreciate the efforts of the ASB to avoid requiring a market value of a settlement cost be determined. Because many of the funds we work with could purchase a few insurance companies themselves, there really is not a market for settling the plan obligations for large public retirement systems. Even for those systems where it is legally possible to do such things as purchase annuities for retirees, the state governments are still frequently the back-up for failed insurance companies – and so the sponsoring government would most likely be responsible for benefit payments if the insurer failed, meaning the risk is not really completely transferred. This, however, is a reminder that a settlement cost in 3.11.c.2 does not really fully settle liabilities.

Section 3.11 is stated to be applicable to funding valuations. As a practical matter for public plans, any study of proposed changes to benefits or funding policies will require an analysis be performed on this basis as well as the funding basis, since the decision makers will need to know the implications of any proposed changes for the risk defeasement cost to be disclosed. Later we discuss some of the issues relating to multiple measures of a liability, but it should be emphasized that this measure will be guiding decisions and will be higher profile than just a simple disclosure in a report.

While the cost to defease investment risk may be of interest to some, we anticipate that it will not be a useful measure for many public retirement systems. After all, it reflects an action that cannot be implemented by most plans. Most public plans are open to new members and many are prohibited from reducing future benefits for anyone who is in the plan. Attempting to defease the risk on a hypothetical benefit for a mid-career employee is purely an academic construct – the accounting effort to actually carry out such a task would be incredibly challenging. Of course, as noted earlier, there are not financial instruments available that can actually defease the risk over the 80-100 years of remaining payouts expected to be made to current members. Further, these plans are investing in diverse portfolios designed to take an appropriate level of risk so as to provide benefits at a lower cost than could be managed in the absence of risk. In fact, the trustees of the plan are required by law to be prudent, and it is doubtful that a "no risk" investment portfolio would be deemed prudent. Thus, actuaries will be required to disclose a cost of an action that is neither legal, possible nor desirable. We realize that some other disclosures may not be useful or appreciated by the clients we serve, but such information tends to either be needed for other actuaries to opine on the reasonableness of the work, or to alert the plan sponsors of some potential problem that they need to know about. This disclosure, however, does not assist other actuaries in reviewing the work (and, in fact, adds another item to review) and does not in most situations give the sponsor any useful information since there is no opportunity to actually defease risk. On the contrary, our clients will have to pay to have this work done, causing a small amount of actual harm to their funding situation. We question how such a requirement benefits anyone beyond answering some academic curiosities.

The final concern we have with Section 3.11 is that this measure may not be fully understood by those who see the number. While actuarial reports for corporate plans are presented to CFOs, human resource managers, and others in similar positions, public plan actuarial reports are placed on web sites, presented to legislative committees, and written about in newspapers. We believe that it is fully possible to explain to corporate senior management the nuances of unit credit versus entry age normal and funding discount rates versus risk-defeased yield curves, but we note that many in the general public may not be as familiar with these concepts as the typical CFO. While the general public is not a direct intended user of these actuarial reports, those of us who practice in this area are cognizant that the broad public is an indirect user.

As an illustration of this, the American Academy of Actuaries wrote the Missouri State Employees' Retirement System Board a letter on October 23, 2017 in which they noted several times that the information provided to certain deferred vested employees might not be fully understood. In our experience, state employees have, on average, a higher level of formal education than the general population. If the Academy is correct in their concern that these individuals (with no particular actuarial background) would not understand certain actuarial concepts, why do we think the general public will understand these points?

Providing two sets of liability measurements in the same report that differ because of an alternate purpose makes sense to us as actuaries. It likely makes sense to those people we work for when we have had sufficient opportunity to provide background and education. For the general public, however, two sets of numbers may serve to create confusion. Because most public retirement systems must make their valuation reports available to the public, the presence of two sets of numbers can be easily misunderstood or intentionally misused. While under Precept 8 of the Code of Conduct actuaries must take reasonable steps to make sure that our work product is not used to mislead others, publicly presenting two sets of numbers will allow those with an agenda to eliminate public retirement plans the opportunity to say that the higher number is the "true" liability. They will be able to assert that actuaries are perhaps being dishonest in providing the calculation used for plan funding purposes. Apart from this intentional misuse, it would certainly be an easy argument that "actuaries make up all these numbers – look how different these two numbers are". Actuaries are thus maligned as somewhere between being arbitrary to being outright liars – certainly not a step towards advancing the profession.

We strongly believe that this section 3.11 should include an "actuary shall consider" clause to provide for discretion when the issuance of additional disclosures will create confusion, especially since these disclosures are for an action that is neither possible, nor desirable for public retirement systems. In light of the ASOP 51 suggestion of a measure such as this as being an option, we actually believe 3.11 could be eliminated altogether.

Section 3.14

The proposed language for this section should be modified to indicate that this applies only when amortizing a positive unfunded liability, and not when there is a negative unfunded liability (sometime called a surplus). As written, there could be some ambiguity in this regard.

We also believe, if this section will be prescriptive rather than principle-based, that there should be some clarification regarding the phrase "[i]f the actuary selects" to address the situation when legislation or the retirement system boards select the method with some degree of input from the actuary. In the public sector, the actuary rarely is able to solely select the actuarial methods or assumptions, but nonetheless often has significant influence on the process. If the language read "if the actuary has sole authority and selects" or "if an actuary recommends" it would be clear that the actuary was still allowed to use a method adopted by a board against the actuary's recommendation.

Section 3.16

The proposed language for this section should be modified to allow for a contribution rate to remain above the actuarially determined contribution for an indefinite time. The language in 3.16.a prevents the smoothed rate from being too much higher, which should provide protection against unreasonable intergenerational equity issues. We do not see any reason that a smoothing method should be compelled to be lowered, which 3.16.b currently requires. Some cash balance plans intentionally contribute well above the actuarial rate so as to provide the opportunity for "surplus" to be added to member's accounts.

Section 3.20

This section applies for funding valuations when there is not a prescribed method or assumption set by law. In the real world, this will essentially be applicable to funded church and public plans. As noted earlier, many, if not most, public plans have some additional legislative requirements for setting a method or assumption, but these requirements do not meet the definition of "prescribed assumption or method set by law" as defined in ASOP 4. Frequently, the legislative methods will nonetheless meet the requirements of this section, so that the actuary need only show one set of contribution numbers. In other cases, however, the actuary may be compelled to calculate an alternate contribution rate that may not be materially different from the legislated rate in order to satisfy the requirements of this section. There are real cases where the current method used does not technically meet the requirements of the proposed language, but our reasonable and compliant alternative would be identical. We can't help but wonder if our work to provide a distinct "compliant" actuarial rate that is nearly or completely identical to the "non-compliant" rate may, in fact, serve to discredit the actuarial profession.

We note that section 3.19 requires the actuary to disclose if a funding policy will not accumulate sufficient assets to pay the benefits of the plan. Ultimately, this is the central issue at stake. If there is a policy in place that will accumulate sufficient assets, there is little apparent value in providing an alternate measurement of a contribution rate. We believe that the requirements of 3.20 should be applicable only if the actuary has reason to believe that the current funding policy is inconsistent with accumulating sufficient assets. In that situation, the additional information serves to illustrate the needed change in contributions to fund the promised benefits, information which would be needed by the plan sponsor. (Of course, the solution may be to reduce benefits rather than increasing contributions – this paragraph presumes that contributions are the only solution.)

Section 3.20.g calls for the reflection of timing between the measurement date and the contribution date. For public retirement systems with multiple tiers (where successive tiers usually have lower benefits and normal cost rates) where the contribution rate is determined as of a measurement date a year or two before the implementation of the rate, this may add a great deal of complexity for very little value. The requirement, as written, does not allow for the actuary to exercise judgment regarding the significance of the factors involved. May the actuary ignore the anticipated reduction in normal cost rate of a few basis points? Must the actuary reflect that school district payroll is not exactly uniform throughout the year? May materiality be considered? In on-going plans, such differences are frequently inconsequential when compared to the probable variation in population size, payroll experience, and the like. This provision should be restated to include the phrase "The actuary should consider…" so as to avoid prescribing a high level of detail which will only serve to increase the complexity of the calculation with little impact on the result.

Concluding Thoughts

The Background section of the exposure drafts indicates that these proposed changes were made in response to the Pension Task Force, which in turn was formed in response to concerns about public sector pension plans. The implication seems to be that the additional requirements of these ASOPs will somehow provide actuaries with the guidance that is needed to help them act in a way that leads to changes in how public pension systems are valued, funded, designed, or presented. As we reflect over the past decade or so, there have been major shifts that have occurred with public retirement plans:

- the distribution of investment return assumption has shifted significantly lower
- the mortality assumptions of many systems has moved to a generational mortality basis, including some systems that adopted these changes around 2005
- contribution rates for employers have increased in most systems, and members have increased contributions in many cases, as well
- benefit provisions for new hires (and for future accruals where legal) have been reduced or adjusted to share risk
- contribution determination methods have been developed to help move toward fully funding on-going plans, with some systems targeting funded ratios in excess of 100%
- the practice (inadvertently prompted by accounting standards) of an open 30-year level percentage of payroll amortization method has all but disappeared
- the level of detail provided to board members and the general public has increased significantly

Through all of this, we see actuaries playing a significant role in helping public policy-makers make these changes. This does not suggest that actuaries are unsure of what to do and needing additional guidance, but rather that actuaries are able to work from the existing principles of the ASOPs to help advance the practice and solve problems.

With these proposed prescriptive requirements, however, actuaries may be placed in a position of pointing out that a requirement of a state law is in conflict with actuarial standards, and supply the "correct" number that is nearly identical. (We realize "correct" is not what the ASOP says, but it is how the public will understand it.) Then the actuary will show two values for what would appear to many as the plan liability – proving to some that actuaries simply make up the numbers or lie.

What is not clear is that any of these proposed changes will cause law-makers to suddenly realize that they must make changes to public policy and choose pension funding over road improvements or school funding. They may believe that their role as elected officials is to serve the citizens who elected them by guiding public policy and making the challenging choices about how limited resources are to be allocated to best serve the public over time. And they may be right.

Cavanaugh Macdonald Consulting would strongly encourage more deliberation and discussion before implementing any changes.

Sincerely,

Brent A. Banister

Brent. A. Banister, PhD, FSA, EA, FCA, MAAA
Chief Actuary

CALSTRS
HOW WILL YOU SPEND YOUR FUTURE?

July 23, 2018

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

SUBJECT: Comments on the 2018 Proposed Revision of Actuarial Standard of Practice (ASOP) No. 4

Dear Members of the Actuarial Standards Board:

The California State Teachers' Retirement System (CalSTRS) thanks the Actuarial Standard Board (ASB) for the opportunity to provide comments on the proposed revision to Actuarial Standard of Practice (ASOP) No. 4.

CalSTRS, with a portfolio valued at $224.9 billion as of May 31, 2018, is the largest educator-only pension fund in the world. CalSTRS serves California's more than 933,000 public school educators and their families from the state's 1,700 school districts, county offices of education and community college districts. CalSTRS administers a hybrid retirement system consisting of a traditional defined benefit, a cash balance and voluntary defined contribution plan.

CalSTRS relies on both internal actuarial staff and an outside actuarial firm, Milliman, to provide appropriate, meaningful and understandable information related to the disclosure of risk and potential variability of funding levels and contribution requirements to CalSTRS board members, policymakers, stakeholders and the public. To ensure only appropriate and meaningful disclosure is provided, CalSTRS believes ASOPs should remain principles based and should leave the details and manner to communicate disclosure elements of risk to the professional judgment of the actuary. This is especially important since, as is the case for most public pensions in the United States, CalSTRS operates in a highly visible environment and is often the focus of scrutiny from the media, policymakers, and others.

Following are our comments and concerns related to the proposed changes to ASOP no. 4.

Comment 1 - Require Disclosure of an Actuarially Determined Contribution (ADC)

CalSTRS would first like to begin by commending the ASB for proposing that an actuary performing a funding valuation should calculate and disclose an Actuarially Determined Contribution (ADC).

CalSTRS is subject to statutory limitations when it comes to setting contribution requirements to properly fund pension benefits. We believe it is important to disclose to trustees, the plan sponsor and the public whether the contributions made to a pension plan are sufficient to ensuring the proper long term funding of the pension obligations. Our funding valuation has for years compared the contributions coming into the system to an actuarially determined amount necessary to properly fund CalSTRS long term.

For this reason, the ASB should consider requiring the disclosure of an ADC determined independently of any statutory limitations even for plans for which a method is set by law.

Comment 2 – Long Standing Practice of ASOP Being Principle Based

CalSTRS would like to remind the ASB that ASOPs have historically been principles-based and have not prescribed specific actuarial practice/calculation. This philosophy is even stated in ASOP No. 1, Section 3.1.4 which says:

> “The ASOPs are principles-based and do not attempt to dictate every step and decision in an actuarial assignment. Generally, ASOPs are not narrowly prescriptive and neither dictate a single approach nor mandate a particular outcome. Rather, ASOPs provide the actuary with an analytical framework for exercising professional judgment, and identify factors that the actuary typically should consider when rendering a particular type of actuarial service. The ASOPs allow for the actuary to use professional judgment when selecting methods and assumptions, conducting an analysis, and reaching a conclusion, and recognize that actuaries can reasonably reach different conclusions when faced with the same facts.”

The proposed Section 3.11 of ASOP No. 4 directs an actuary performing a funding valuation to calculate an Investment Risk Defeasement Measure (IRDM) through a prescribed approach, directly conflicting with ASOP No. 1 and its statement that “ASOPs are not narrowly prescriptive and neither dictate a single approach nor mandate a particular outcome.” As currently written, Section 3.11 is prescriptive, prevents the actuary from exercising professional judgment and dictates a single approach.

Comment 3 - Conflict with Actuarial Code of Professional Conduct

Prior to requiring the disclosure of an IRDM as currently proposed in Section 3.11, the ASB should consider Precepts No. 4 and 8 of the actuarial Code of Professional Conduct promulgated by the American Academy of Actuaries.

Precept 4 of the Code of Professional Conduct states:

> “An Actuary who issues an Actuarial Communication shall take appropriate steps to ensure that the Actuarial Communication is clear and appropriate to the circumstances and its intended audience and satisfies applicable standards of practice.”

Precept 8 of the Code of Professional Conduct and its Annotations states:

> PRECEPT 8. “An Actuary who performs Actuarial Services shall take reasonable steps to ensure that such services are not used to mislead other parties.”
>
> ANNOTATION 8-1. “An Actuarial Communication prepared by an Actuary may be used by another party in a way that may influence the actions of a third party. The Actuary should recognize the risks of misquotation, misinterpretation, or other misuse of the Actuarial Communication and should therefore take reasonable steps to present the Actuarial Communication clearly and fairly and to include, as appropriate, limitations on the distribution and utilization of the Actuarial Communication.”

As per proposed Section 3.11 of ASOP No. 4, an actuary performing a funding valuation would be required to disclose a pension obligation measure that is based either on a discount rate using US Treasury yields or rates at which the pension obligation can be settled. We believe that the disclosure of such measures is not appropriate to CalSTRS circumstances and CalSTRS intended audience. It is important to remember that California has a strong legal framework that governs and protects the accrual of pension benefits for CalSTRS members. CalSTRS pension obligation cannot be settled and are guaranteed ultimately by the State of California.

We believe that the disclosure of an IRDM will lead to the use of the measure to mislead stakeholders, policymakers, the media, pension plan participants, and the general public about the funding condition of the pension plan. The IRDM seems to be precisely the type of misuse that Precepts 4 and 8 are intended to avoid.

It is very easy to find examples in the media today where public pension plans are being accused of lying and not disclosing what some are saying is the “true” cost of pensions. In California, CalSTRS has been subject to such misleading publicity on multiple occasions. Here is an example:

> “Notice how CalPERS is choosing to value liabilities at the same rate as it expects to earn on assets. … As Nixon said, it’s the lie that gets you. CalPERS’s lies harm citizens. By linking discount rates to investment return assumptions, CalPERS and its sister pension fund, CalSTRS, are being untruthful. The lies get exposed when citizens get hit with pension deficits.”
>
> David Crane, “It’s the Lie That Gets You” medium.com article, March 4, 2017

As actuaries, we understand that choosing the right measure of a pension obligation depends on the purpose of the measurement. Contrary to what some critics of public pensions have stated publicly, there is not one true measure compared to which all other measures are deceptive to the public. We urge the ASB to consider very seriously the implication of mandating the disclosure of an IRDM using a prescribed method as it is likely going to be used to mislead other parties that its purpose is to measure the true cost of the pension promise. Making it a mandated calculation will almost certainly be used as evidence that it is the only true measure of cost.

Comment 4 - IRDM is Not an Appropriate Measure of Investment Risk

As currently defined, the IRDM is not an appropriate measure of investment risk. As stated in the proposed ASOP No. 4, the purpose of the IRDM is to measure the cost to defease the investment risk for a pension plan. If this is the true purpose, then the current language would not properly measure the cost to eliminate investment risk for CalSTRS and most public pension plans.

The proposed IRDM requires the use of the unit credit cost method and would not recognize any potential future pay increases for plan participants. It is important to remember that California has a strong legal framework that governs and protects the accrual of pension benefits for CalSTRS members. CalSTRS always measures liabilities by taking into account future expected pay increases. Any disclosure of liability which does not reflect future pay increases would be underestimating the funding targets / liabilities of the plan and would not properly represent the cost of eliminating investment risk.

If the intent of the IRDM is really to determine the cost to eliminate/defease the investment risk of a plan then it needs to be one based on a cost method that does incorporate future expected salary increases – such as the Projected Unit Credit (PUC) or Entry Age Normal.

CalSTRS would like to note that ASOP No. 51 recognized this and included language in Section 3.4 stating that if the actuary were to assess plan liabilities using a lower discount rate, that it be done on a basis consistent with the basis used to assess the plan on-going liabilities. The language of ASOP No. 51, Section 3.4 says:

> "… a comparison of an actuarial present value using a discount rate derived from minimal-risk investments to a corresponding actuarial present value from the funding valuation or pricing valuation."

Comment 5 - Disclosure of Risk Belongs in ASOP No. 51

Proposed Section 3.11 of ASOP No. 4 clearly defines the IRDM as a risk measure. We believe that any examination and assessment of the investment risk belongs in ASOP No. 51, Assessment and Disclosure of Risk Associated with Measuring Pension Obligations and Determining Pension Plan Contributions.

It is worth noting that ASOP No. 51 already contains principles-based guidance to evaluating pension plans' investment risks and that it does not prescribe one method for assessing risk. Instead, ASOP No. 51 suggests various methods for assessment of risk. Any of the methods listed in ASOP No. 51 would be more generally applicable than the proposed IDRM. The language of ASOP No 51 says:

> "Methods may include, but are not limited to scenario tests, sensitivity tests, stress tests, and a comparison of an actuarial present value using a discount rate derived from minimal-risk investments to a corresponding actuarial present value from the funding valuation or pricing valuation."

It is also important to remember that the ASB just recently completed a thorough process that led to the creation of ASOP No. 51. We believe that additional time must be provided to let ASOP No. 51 operate to see how it will help improve the disclosure of risk related to measuring pension obligations and determining pension plan contributions.

At CalSTRS, we are strong believers in meaningful and appropriate disclosure of risk. We should not be required to disclose a prescriptive, arbitrary and potentially misleading measure of risk such as the IRDM and instead be given the flexibility, as currently provided in ASOP No. 51, to select the appropriate approach to disclose risk. This flexibility is necessary to ensure all of CalSTRS interested parties have the right understanding of the risk inherent in the funding of CalSTRS pension obligations. There are reasons why CalSTRS never produced a number similar to the proposed IRDM in the past. What would a CalSTRS trustee do with this information? What action would or should a CalSTRS trustee take based on learning the plan's IRDM? We believe other measures of risk better serve CalSTRS board members and California policymakers.

That is why for the last few years, even before the issuance of ASOP No. 51, CalSTRS has been producing an annual report entitled "CalSTRS Review of Funding Levels and Risks". This annual report has been produced with the intent to educate board members, policymakers and stakeholders on the risks inherent in the funding of the system. We believe this report illustrates well why actuaries must retain the ability to apply professional judgement in choosing the appropriate ways to disclose risk. For your information, a copy of the most recent report can be found at the following link:

https://www.calstrs.com/sites/main/files/file-ttachments/funding_risk_report_2017.pdf

Comment 6 - True Intent of IRDM

It is no secret to anyone that for years a certain group of individuals, including several actuaries have attempted to put pressure on various accounting and actuarial organizations to lead to the disclosure of a solvency/market value type of liability for public plans using risk free discount rates. If the real intent of the IRDM is to require the disclosure of a solvency/market value liability to satisfy certain users of actuarial reports then the ASB should not make this a disclosure requirement. Entities in need of a solvency/market value of liability have demonstrated in recent years that they can produce estimates of such liabilities for their purposes independently. They should continue to do so and actuaries should not be required to disclose such number. A mandated IRDM in a funding valuation would be interpreted as an endorsement of a measure that is frequently misrepresented as "the one true answer" of the condition and cost of a public pension plan.

Comment 7 – May Violate Fiduciary Duties

As stated earlier, California has a strong legal framework that governs and protects the accrual of pension benefits for CalSTRS members. Calculating an IRDM is a mere academic exercise that offers little to no practical value and would be of no use to CalSTRS trustees, policymakers and its stakeholders. Mandating CalSTRS to incur additional expenses by requiring its consulting actuarial firm, Milliman, to produce an IRDM as part of the funding valuation is not only a waste of public pension assets, but may also be a violation of fiduciary duties, particularly when looking at the requirement that CalSTRS operate solely in the interest of CalSTRS members.

Conclusion

CalSTRS believes that standards of practice should remain principles based and avoid imposing prescriptive requirements on actuaries. For this reason, we agree with most of the proposed changes in ASOP No. 4 except for Section 3.11. We strongly recommend against the proposal to require the disclosure of an IRDM or any other types of solvency liability measure as proposed in Section 3.11. Any such risk measures belong in ASOP No. 51. The ASB must not break from its long standing practice of letting actuaries exercise professional judgment in determining the appropriate approaches to disclose meaningful information related to the risks inherent in the funding of pension plans.

Thank you for considering our response.

Sincerely,

Rick Reed	David Lamoureux	Jordan Fassler
System Actuary	Deputy System Actuary	Senior Pension Actuary
CalSTRS	CalSTRS	CalSTRS

July 25, 2018

ASB Comments
American Academy of Actuaries
By email: comments@actuary.org

Re: ASB Actuarial Standards of Practice No. 4 Exposure Draft

Dear Members of the Actuarial Standards Board:

We are writing on behalf of our members, who are the directors, administrators, managers, and trustees of public retirement systems throughout the United States. These systems hold more than $4.0 trillion in trust to provide pension and other benefits on behalf of more than 24 million working and retired employees of state and local government in the United States.

Public pension plans operate in a highly visible environment, overseen by elected governmental bodies at the state and local level and subject to scrutiny by the media and various stakeholder groups. These plans also are subject to constitutional, statutory, and case laws that create a clearly defined legal framework that governs the accrual and protection of pension benefits. We support the appropriate, meaningful, and understandable disclosure of the funded status and contribution requirements of public retirement plans so that stakeholders fully understand the nature, extent, and potential variability of the pension obligations.

For these reasons, the accuracy, clarity, and integrity of actuarial calculations and disclosures are vital to the ability of public pension plans to fulfill their legal responsibilities, and actuarial requirements and standards of practice are a matter of great relevance to us. We appreciate the opportunity to submit comments in response to the Exposure Draft of Actuarial Standards of Practice (ASOP) No. 4.

Following are our specific concerns about the exposure draft.

Comment 1: ASOP 51 already provides a robust framework for the assessment of risk, and the Investment Risk Defeasement Measure (IRDM) is a poor measure of risk

We believe that any guidance on the examination and assessment of investment risk belongs in ASOP 51, *Assessment and Disclosure of Risk Associated with Measuring Pension Obligations and Determining Pension Plan Contributions*, which already contains principles-based guidance on evaluating pension plans' investment risks. ASOP 51 was specifically written to measure and report on pension plan risk, and already provides a robust framework for assessing investment and other risks inherent in funding plan benefits. ASOP 51 specifies investment risk as the first example of risk an actuary should identify and assess, and provides the framework, methods, and considerations for identifying and assessing investment risks.

By contrast, the prescribed IRDM in the proposed revision of ASOP 4 is not an effective measure of the investment risk in funding a plan. In fact, the prescribed IRDM is actually a measure of the liabilities of the plan for benefits accrued to-date, if the future investment risk is eliminated by investing the fund in assets with an expected yield equal to current bond yields. Because the IRDM is based on different assumptions and a different funding method than those used in most public pension funding valuations, this proposed metric is neither an effective nor a useful measure of the investment risk in funding ongoing benefit accruals. Moreover, the proposed IRDM does not provide a basis to assess the impact of investment risk inherent in the plan's asset allocation – which could result in higher or lower future contribution requirements. Investment risk can and should be measured and assessed as part of ASOP 51.

The appropriate measure for determining the cost to defease the investment risk of a plan would need to be one based on the same cost method that is used for funding. ASOP 51 recognized this and includes language stating that if the actuary were to assess plan liabilities using a lower discount rate, that it be done on a basis consistent with the basis used to assess the plan on-going liabilities. The language of ASOP 51, Section 3.4 says: "… a comparison of an actuarial present value using a discount rate derived from minimal-risk investments to a corresponding actuarial present value from the funding valuation or pricing valuation."

Per the proposed new Section 3.11 of ASOP 4, other assumptions used in the calculation of the IRDM are to be those used in the funding valuation or "based on estimates inherent in market data, in accordance with ASOPs Nos. 27 and 35." However, there may be no market data on other assumptions and the other assumptions used in the funding valuation or inherent in market data may be wholly inappropriate in the context of defeasing liabilities. This may force the actuary to decide whether to adhere to Section 3.11 of the proposed revision to ASOP 4, or to the consistent assumption provisions in Section 3.12 of ASOP 27 and Section 3.7 of ASOP 35.

ASOP 51 deliberately and appropriately does not include mandatory quantitative risk assessments, nor does it require a specific one. Instead, ASOP 51 suggests various methods for assessment of risk. Many of the methods listed in ASOP 51 would be more generally applicable than the proposed IRDM. Meanwhile, as discussed above, calculating and reporting both an IRDM and complying with ASOP 51 inevitably will lead to misinterpretation, misuse, and confusion.

Comment 2: The intended purpose and application of an IRDM is unclear, particularly for risk-sharing plans

We are unaware of an instance in which such a number has actually been used by a public pension plan. How does the ASB perceive the IRDM being used by decision makers? What would a public pension trustee do with this information? What action would or should a public pension trustee take based on learning the plan's IRDM?

As an example, consider a public pension plan with $7 billion in assets and $10 billion in actuarial accrued liability, measured at a discount rate of 7.0 percent. Suppose the IRDM measure is $15 billion. What does a trustee do with that information? The measure provides no information about the affordability about the possible consequences of the plan's investment risks. The only clear conclusion a trustee could draw is that if the plan had another $8 billion in assets, the plan could immunize its obligations with very safe investments. That information is likely to be of limited interest to trustees and certainly doesn't warrant a mandatory disclosure. Moreover, as discussed later in this letter, we know that some will use (or misuse) that information, characterizing it as “the one true number,” to accuse public pension plans of keeping two sets of books, etc.

For plans with risk-sharing or variable benefit features, it is highly likely that other funding valuation assumptions regarding variations in benefit features would be inconsistent with defeasement or with investment returns equal to yields of a bond portfolio and therefore violate Section 3.12 of ASOP 27 or Section 3.7 of ASOP 35. No guidance is provided for such situations.

The meaning and utility of the IRDM is even more ambiguous in cases of risk-sharing pension plans in which benefits are determined partly by external factors. For example, some public pension plans pay a cost-of-living adjustment that is based on the plan’s funding level or on the fund’s investment performance relative to some benchmark. An IRDM calculated on the basis of a Treasury bill return for a plan whose COLA is based on returns above a certain threshold, for example, would produce a particularly nebulous number. Similarly, some plans pay a COLA if investment returns exceed the plan’s assumed rate of investment return. If the IRDM requires that the actuary assume an investment return of a low-risk bond rate of say, 3.0 percent, investment risk may remain but the IRDM would not represent the amount of assets needed to “defease” the investment risk as is implied by the name and stated objective in the standard. Such an outcome would reasonably be considered to be misleading.

Considering the large and growing number of risk-sharing elements that are embedded in public pension plan designs, we believe this to be an especially troublesome matter.

Comment 3: The IRDM has limited relevance to public plans.

As prescribed, the IRDM is a settlement value, also known as the risk-free version of the so-called market value of liabilities (MVL). We would note that during the most recent round of reviews of ASOPs 4 and 27, the ASB considered, and ultimately declined, to define an MVL, electing instead to focus on the purpose of the measurement. We believe that guidance to be both appropriate and sufficient, especially in conjunction with the new ASOP 51 on risk assessments.

Because interest rates and bond yields are fluid and can be volatile, determining a measure based on a spot-price, and contending that it “effectively” defeases the investment risk of a large public pension plan with perdurable future cash flows, not only is unrealistic, but also produces a measure that has no relevance to the plan’s funding valuation and that does not consider the plan’s legal environment.

Most public pension plans are legally obligated to pay promised benefits, and public plan sponsors in many or most cases are forbidden from withdrawing from the plan. In addition, a growing number of public pension plans contain risk-sharing elements. We believe these facts render moot the meaning, relevance and utility of a mandatory public pension settlement value, or an MVL.

If a requirement to calculate an IRDM is to be established, we would suggest that such a requirement should be a) limited to those plans whose employers are legally permitted to withdraw; and b) contained in an advisory letter, similar to a management letter used by auditing professionals, and not within the contents of the valuation. In some cases, statutes specify that the purpose of actuarial valuations is to calculate contribution rates. Providing the information in an advisory letter separate from a valuation still informs policy makers, but will not come into conflict or confusion with such statutes. For plans whose employers lack such authority, the IRDM has limited relevance.

Comment 4: Requiring pension plans to pay for the calculation of a value that, in many cases, is of marginal utility, is unreasonable and may violate public pension fiduciary duties.

An Investment Risk Defeasement Measure reflects the cost of nullifying or abrogating a pension benefit. Yet public employers in many states are prohibited from leaving, or disaffiliating, from the retirement system that provides pension benefits to their employees. For public pension plans whose employers are legally obligated to pay promised benefits and to continue to provide benefits in the future, calculating an IRDM is a mere academic exercise that offers little to no practical value. As shown in results of a NASRA survey on policies governing employer disaffiliation from statewide retirement systems public pension obligations in many instances must not only be paid, but also must be allowed to continue to accrue for plan participants who continue to work.

A requirement that a public pension plan must pay an actuary to calculate a value that is based on an event that is in contradiction of the laws governing the plan, not only is a waste of limited public pension assets, but also may require public retirement system trustees and administrators to violate their fiduciary duties, particularly the requirement that they operate solely in the interest of plan participants. Moreover, an actuary in such cases may be unable to affirm in good faith the reasonableness and consistency of actuarial calculations that include the IRDM.

A mandated IRDM in a funding valuation would be interpreted as an endorsement of a measure that is frequently misrepresented as "the one true answer" of the condition and cost of a public pension plan. Such a mandate, for the mere purpose of satisfying those with an interest in this number, is neither good actuarial nor public policy. Moreover, requiring a retirement system to pay for such a calculation is a misuse of public pension assets. Entities that want a settlement/MVL number have demonstrated in recent years that they can independently produce estimates of such liabilities for their purposes.

Comment 5: The Investment Risk Defeasement Measure conflicts with the actuarial standard that standards should not be prescriptive

ASOP 1 states:

> The ASOPs are principles-based and do not attempt to dictate every step and decision in an actuarial assignment. Generally, ASOPs are not narrowly prescriptive and neither dictate a single approach nor mandate a particular outcome. Rather, ASOPs provide the actuary with an analytical framework for exercising professional judgment, and identify factors that the actuary typically should consider when rendering a particular type of actuarial service. The ASOPs allow for the actuary to use professional judgment when selecting methods and assumptions, conducting an analysis, and reaching a conclusion, and recognize that actuaries can reasonably reach different conclusions when faced with the same facts.

By directing the actuary to calculate an IRDM, and by prescribing how the IRDM is to be calculated, Section 3.11 of the ASOP 4 Exposure Draft conflicts directly with ASOP 1 that "ASOPs are not narrowly prescriptive and neither dictate a single approach nor mandate a particular outcome." Section 3.11 is wholly prescriptive; it leaves no room for professional judgment on the part of the actuary; and it dictates a single approach.

Public pension plans rely on professional actuaries to employ their professional training, knowledge, and judgment to fairly and accurately assess the condition and cost of the plans our members oversee. A requirement that these actuaries conduct a calculation using a prescribed formulaic process, including factors that in many cases are irrelevant to plans' legal and operating environment, contradicts both the letter and spirit of ASOP 1.

Comment 6: The Investment Risk Defeasement Measure conflicts with the actuarial Code of Professional Conduct in two ways: that actuarial communications should be clear and appropriate to the circumstances and its intended audience, and that actuarial services should not mislead.

Precept 4 of the Code of Professional Conduct, promulgated by the American Academy of Actuaries, states:

> An Actuary who issues an Actuarial Communication shall take appropriate steps to ensure that the Actuarial Communication is clear and appropriate to the circumstances and its intended audience and satisfies applicable standards of practice.

Precept 8 of the Code of Professional Conduct states:

> An Actuary who performs Actuarial Services shall take reasonable steps to ensure that such services are not used to mislead other parties. ... The Actuary should recognize the risks of misquotation, misinterpretation, or other misuse of the Actuarial Communication and should therefore take reasonable steps to present the Actuarial Communication clearly and fairly and to include, as appropriate, limitations on the distribution and utilization of the Actuarial Communication.

As described above, a public pension obligation measure that is based on a discount rate using US Treasury yields or a settlement value is not, in many instances, appropriate to the circumstances and its intended audience. Likewise, we believe that such a measure will be used to mislead stakeholders—policymakers, the media, pension plan participants, and the general public—about the condition of the pension plan. The IRDM seems to invite precisely the type of misuse that Precepts 4 and 8 are intended to avoid.

The IRDM can be expected to be used to mischaracterize the condition of public pension plans. An abundance of evidence demonstrates that a measure based on a discount rate using US Treasury yields or settlement value routinely has been cited as the "true" measure of the funding condition of public pension plans, despite the fact that many of these plans cannot legally terminate, are obligated to pay promised benefits, and are sponsored by states and other entities that are essentially perpetual. Such evidence includes published news accounts [in the appendix to this letter] quoting adherents to financial economics, who reject conventional public pension funding measures and instead assert that the actual measure of public pension plan funding is based on US Treasuries and settlement values.

In recent years, following the onset of new public sector accounting standards and the establishment by some bond ratings agencies of proprietary methods for valuing pension obligations, multiple measurements of public pension plans have become more common and have received more attention. These metrics have led to confusion and selective use, rather than the clarity and consensus we believe is provided by using a measurement of public pension plans based on their long-term expected investment return in compliance with public sector accounting standards and longstanding practice. Requiring the actuary to calculate and communicate a defeasement liability in connection with the funding valuation will increase the number of "official" funding liability measures, and will exacerbate the problems of confusion and misuse. The burden of explaining to legislators, plan sponsors and other stakeholders the purported meaning and limited usefulness of the IRDM will fall on our members--public retirement system directors and their staff and trustees.

In addition, requiring disclosure of an IRDM simply to satisfy those who are interested in such a number, is not good public policy. As public pension plans are subject to open meetings and open records laws, no reasonable steps are available to actuaries who perform actuarial analyses to preclude such misuse as required by Precept 8. Any disclaimers or conditions prepared by the actuary on the appropriate use of the IRDM undoubtedly will be left behind when that value is used to misrepresent the plan's funding requirements.

Comment 7: Requiring calculation of an IRDM may be a result of the ASB not following its traditional processes for proposing ASOP modifications

Because the ASB did not adhere to its traditional process for proposing changes to ASOPs, we are concerned about the outcome of the process the ASB used, as that process resulted in what we believe to be a flawed proposal, i.e., a requirement to calculate the IRDM. Although we are not professional actuaries and we do not wish to tell the ASB how to conduct its business, as consumers of professional actuarial services, we are affected by the process ASB uses to make decisions. Because we believe the proposal to require an IRDM is flawed, and in consideration of this proposal's potential consequences, we would prefer that the ASB follow its traditional due diligence in modifying its standards.

Based on previous exposure drafts and on the ASB's Procedures Manual, our understanding is that the ASB's Pension Committee typically drafts new guidance related to pension plans Accordingly, it would have been reasonable to expect that the Pension Committee would have reviewed the responses to the ASB's July 2014 Request for Comment, and that, based on that review, the Pension Committee would have formulated and drafted any proposed changes to the ASOPs. Instead, we understand that the ASB appointed a Pension Task Force made up of just a few actuaries to review the responses. The Pension Task Force report included several "suggestions," including the IRDM disclosure requirement. The ASB then directed the Pension Committee to draft these suggestions as a new standard, in effect replacing the role of the larger and more representative Pension Committee with the smaller and less representative Pension Task Force.

As a result, the outcome of the Request for Comments, namely, to require the IRDM, was determined not by the broader consensus of the Pension Committee, but rather by the particular individuals selected for the Task Force. Moreover, at the same time the Pension Task Force was considering suggestions for changes, the ASB was also finalizing and adopting ASOP 51 regarding the identification and assessment of risk. If the IRDM requirement is indeed a risk measure and is considered to be so essential to be uniquely prescribed, we wonder why was it excluded from ASOP 51? ASOP 51 was only recently adopted and is yet to be effective. Funding valuations subject to ASOP 51 are likely to include meaningful, relevant discussions of investment and other risks inherent in funding a pension plan. We believe it would be prudent for the ASB to observe actuarial practice under ASOP 51 prior to mandating a measurement of questionable risk-assessment value that is likely to be misrepresented by non-actuaries.

We would respectfully suggest that the ASB consider the comments articulated in this letter and issue a revised exposure draft from the Pension Committee, to eliminate a required IRDM, or at least to restrict an IRDM as described in Comment 3.

Once again, we want to express our appreciation for the opportunity to convey our concerns about this proposal. On behalf of our many members and their millions of plan participants, thousands of public employers, and other public pension plan stakeholders, we appreciate your consideration of our views.

Sincerely,

Dana Bilyeu
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Appendix

News Articles Citing a Financial Economics Value for Unfunded Public Pension Liabilities

1. http://altondailynews.com/news/details.cfm?id=227001#.WAeeNSQ7Jrc
2. http://nj1015.com/nj-pension-shortfall-amounts-to-26000-for-every-resident-group-claims/
3. http://www.investors.com/politics/editorials/the-looming-pension-crisis-of-state-and-local-governments/
4. http://www.zerohedge.com/news/2016-10-10/2-simple-charts-show-which-state-pensions-are-most-likely-enforce-benefit-cuts
5. http://www.ahwatukee.com/news/article_5a6e37b4-76ab-11e6-bb3a-bbc3f68b22dc.html
6. http://www.forbes.com/sites/pensionresearchcouncil/2015/08/25/unfunded-pension-debts-of-u-s-states-still-exceed-3-trillion/#2ca16dbe69f0
7. http://www.capoliticalreview.com/capoliticalnewsandviews/actuaries-real-calpers-unfunded-liability-is-946-billion-when-will-it-collapse/
8. http://watchdog.org/207217/pension-texas-ers/
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10. http://seekingalpha.com/article/4005269-defined-benefit-might-risky-defined-contribution
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14. https://www.brookings.edu/opinions/teacher-salary-hikes-face-major-headwinds-politics-and-pension-underfunding/
15. https://www.forbes.com/sites/oliviergarret/2017/06/09/the-disturbing-trend-that-will-end-in-a-full-fledged-pension-crisis/#741e40346620
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17. https://www.forbes.com/sites/jeffreybrown/2012/02/29/the-risk-of-ignoring-risk-the-case-of-pensions/#66b82228bac6
18. https://www.al.com/opinion/index.ssf/2016/05/further_reforms_are_needed_for.html
19. http://freebeacon.com/issues/unfunded-liabilities-state-public-pensions-top-6-trillion-2017/
20. https://www.moodys.com/research/Moodys-Net-pension-liabilities-continue-rising-for-42-of-50--PR_377106
21. https://www.illinoispolicy.org/moodys-downgrades-illinois-to-1-notch-above-junk-warns-state-pension-liabilities-top-250b/
22. https://www.valuewalk.com/2017/06/pension-unfunded-liabilities/

COLORADO PERA

July 26, 2018

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

RE: Comments to ASOP No. 4 Exposure Draft

Members of the Actuarial Standards Board:

The Colorado Public Employees' Retirement Association (Colorado PERA) is pleased to have the opportunity to respond to the recently released Exposure Draft of a proposed revision to Actuarial Standard of Practice (ASOP) No. 4, *Measuring Pension Obligations and Determining Pension Plan Costs or Contributions*. The views shared in this comment letter are those of the staff of Colorado PERA and do not represent the views of the Board of Trustees of Colorado PERA (Board), which has not taken a position on the Exposure Draft.

Colorado PERA was formed in 1931 and administers five defined benefit pension plans [State Division Trust Fund, School Division Trust Fund, Local Government Division Trust Fund, Judicial Trust Fund, and Denver Public Schools (DPS) Division Trust Fund], two defined benefit other postemployment benefit (OPEB) plans [Health Care Trust Fund and DPS Health Care Trust Fund], three defined contribution plans, and a private purpose trust fund.

Colorado PERA's five division trust funds include close to 600 employer reporting units with approximately 207,800 active members, 257,800 inactive members and 118,500 retiree members. In addition to Colorado PERA's annual actuarial valuation, the Board requires its external actuaries to produce actuarial projections for each division and health care trust fund and also a Signal Light Report regarding the five division trust funds which forecasts the likelihood of Colorado PERA meeting its economic and demographic assumptions based on the most recent actuarial valuation results. Copies of Colorado PERA's most recent actuarial valuations and Comprehensive Annual Financial Reports are available at http://www.copera.org.

We would like to thank the Actuarial Standards Board (ASB) for considering public comments to this proposed revision and believe public comments are an integral part of the process to determine standards and related authoritative guidance. Below are our comments to the proposed revision of ASOP No. 4.

First we would like to commend the ASB for the work that has gone into the revisions included in the ASOP No. 4 Exposure Draft regarding Sections 3.14 through 3.21, and Sections 4.1 through 4.2. We note that additional detail could be included in Section 3.14, *Amortization Method*, regarding the acceptance of a layered amortization approach, which Colorado PERA employs in the determination of the Actuarially Determined Contribution for each division trust fund, as delineated in the Colorado PERA Board's Pension Funding Policy. We also would propose the inclusion of guidance regarding amortization of a surplus, as opposed to only addressing the amortization of an unfunded actuarial accrued liability. Other than those two general comments, we will defer to the actuarial firms and actuarial organizations to address the more detailed aspects of these sections.

The majority of our dissenting comments focus on Section 3.11, *Investment Risk Defeasement Measure*, (or "IRDM") included in the ASOP No. 4 Exposure Draft and our belief that this proposed "measure of investment risk" is basically flawed in concept, calculation, and application as currently described in the Exposure Draft. Below we present our assessment of the risks related to the IRDM from our viewpoint as a **public pension plan** that depends upon actuarial expertise and judgement for annual valuation and disclosure purposes. We intend our comments to bring to light specific risks that arise from the requirement of this measurement; risks such as:

- Reasonable assumptions and methods,
- Defendable disclosures,
- Legal interpretations, and
- Actuarial reputation.

Reasonable Assumptions & Methods Risk

Inappropriate Actuarial Cost Method

The unit credit cost method is rarely used for public pension plans regarding funding valuations and is not allowed by GASB for use in valuations for accounting and financial disclosure purposes. Therefore, Colorado PERA staff believes that this cost method is inappropriate for the proposed use, within the public pension plan arena.

Inappropriate Demographic Assumptions

Section 3.11 allows for use of the same non-economic assumptions as those applied in a plan's funding valuation. Based on the description of the discount rate required by this proposed section of ASOP No. 4, the calculation appears to mirror the determination of a settlement liability. However, plan members who no longer earn future service credits or pay increases behave much differently than members in an "ongoing" plan. Therefore, using assumptions intended for an "ongoing" plan in the determination of the IRDM, likely, would not be appropriate.

Unrealistic Discount Rate

Unlike private sector plans, pension plans that serve public entities and thus, large populations of public employees, are typically considered ongoing entities as are the governments they benefit. Therefore it only would be appropriate to value the liabilities of these public pension plans reflecting an ongoing and long-term perspective. With respect to public sector pension plans, Colorado PERA believes the limited choices of discount rates as prescribed by Section 3.11 of the ASOP No. 4 Exposure Draft, are too narrowly defined, reflect only a market-value or settlement rate, and are not representative of a discount rate that would accurately value funding liabilities of an on-going plan.

Purpose of the Measurement

As mentioned in a number of ASOPs, a primary consideration in the selection of actuarial methods and assumptions should reflect the "purpose of the measurement". The IRDM, as delineated in the ASOP No. 4 Exposure Draft, is described as an investment-risk measure. However, as noted above, the assumptions and cost method mandated for use in the calculation of the IRDM do not produce a number that is useful in measuring ongoing investment risk. Therefore, Colorado PERA does not believe the purpose of the measurement, as stated, is being met. We do not believe the proposed IRDM would add value for the users of our funding valuation or contribute pertinent information upon which to base long-term funding decisions. The inclusion of this metric in the final version of ASOP No. 4 would simply be an expensive requirement with no real value to the users.

Defendable Disclosure Risk

Challenges of Explaining Two "Right" Numbers

If the ASOP No. 4 Exposure Draft is adopted as written, given the mandated nature of the IRDM, Colorado PERA is very concerned there will be confusion as to which pension liability value is accurate. Additionally, the issuance of the new pension liability likely would be misinterpreted as a recommendation of the actuary despite any disclosure to the contrary. We believe this approach will unnecessarily cause confusion and misunderstanding among the memberships, employers, legislators, and tax-payers who embody the stakeholders of all public pension plans.

Narrow Viewpoint

The IRDM, as suggested by its name, mainly focuses on investment risk. If the IRDM is truly a measure of risk that should be taken seriously by all pension plans, it should reflect and/or test other aspects of risk. The IRDM also should reflect the expected exposure to investment return volatility inherent in a plan's actual fund portfolio, not be restricted to the use of an arbitrarily prescribed rate of return that has no relationship to the portfolio. Colorado PERA views the IRDM approach as too narrow-minded and believes a more broad-based approach has been sufficiently reflected in the risk assessments suggested in ASOP No. 51, *Assessment and Disclosure of Risk Associated with Measuring Pension Obligations and Determining Pension Plan Contributions.*

Bond Rating Agencies

Many bond rating entities currently determine their own alternative values regarding public pension plans. Therefore, we believe it is likely that one type of "user" of the IRDM information would simply ignore the metric and use the calculations determined by their own organization applying their own methods and assumptions. This would deem the determination of an IRDM practically useless and the confusion it likely will cause among other readers of the actuarial funding valuations (all public plan stakeholders), pointless and unnecessary.

Legal Interpretation Risk

The Legalities of Settlement

Identifying the IRDM as a "settlement measure" may, in effect, limit its relevance within the public pension plan sector. As generally noted in a number of court cases across the United States, it is illegal for most public pension plans to freeze benefit accruals or to settle obligations. The presentation of such a metric in actuarial reports may increase the risk of misuse and/or misinterpretation by implying potential for, most commonly, an impermissible action.

Actuarial Reputation Risk

The ASOP Approval Process

Colorado PERA would like to comment on the apparent and intentional deviation from well-established ASB procedures. Within the characteristic process of the review and revision of an ASOP, the ASB's Pension Committee typically would review and draft any new guidance related to pensions. This step was noted in the review process of the current ASOP No. 4. However, following the ASB's July 2014 *Request for Comment* regarding public sector actuarial practices, the ASB opted, instead, to form a smaller Pension Task Force to review the responses and make suggestions. Colorado PERA questions the ASB's reasoning for deviation from their well-established process.

Recently Revised ASOP No. 4

Perhaps more important, than the deviation from typical procedures as described above, was the notable hasty revisiting of the review of ASOP No. 4. The more traditional review of ASOP No. 4 which took place between January 2011 and December 2013 apparently was discounted as insufficient given the commencement of the latest process of review which commenced almost as soon as the revised ASOP No. 4 was adopted.

Recently Adopted ASOP No. 51

ASOP No. 51, "*Assessment and Disclosure of Risk Associated with Measuring Pension Obligations and Determining Pension Plan Contributions*", was recently adopted as of September 2017 and effective for funding valuations (and other actuarial work-product) performed on or after November 1, 2018. Colorado PERA believes a more appropriate measure of investment risk can be found in ASOP No. 51, which allows for choices between many possible methods of assessing risk related to the pension plan in question.

Conclusions

In the world of public pension plans, governing boards and system staff struggle each day with education of and communications to our stakeholders. We are constantly working toward the defined goals of ensuring transparency and accountability while promoting contribution rate stability and intergenerational equity. In the collective opinion of the staff at Colorado PERA, the hasty and seemingly urgent need for yet another liability measurement, a settlement measurement, is a distinct culmination of risk on every level. We are speaking to the risk of misinterpretation and misuse, inaccurate and inappropriate calculations, impermissible or illegal determinations, and reputational risk for the actuarial profession in general, particularly for those providing actuarial expertise and judgement in the production of annual funding valuations and disclosure information for public pension plans.

As pointed out above, there are a few items included in the ASOP No. 4 Exposure Draft that we find appropriate with the exception of Section 3.11, regarding the required calculation and disclosure of an IRDM. However, Colorado PERA would encourage a more thoroughly researched and appropriately vetted approach in the determination of revisions ultimately to be included in ASOP No. 4.

Again, we appreciate the opportunity to comment on this project. Should you have any questions regarding these comments, please feel free to contact me at rbaker@copera.org.

Sincerely,

Ron Baker

Interim Executive Director, Colorado PERA

AFSCME

We Make America Happen

July 26, 2018

Actuarial Standards Board
1850 M Street, NW
Suite 300
Washington, DC 20036

Submitted electronically via: comments@actuary.org

Re: Proposed Revision of Actuarial Standard of Practice (ASOP) No. 4

Dear Members of the Actuarial Standards Board:

The American Federation of State, County and Municipal Employees (AFSCME) is pleased to submit comments in response to the Actuarial Standards Board's Proposed Revision of Actuarial Standard of Practice (ASOP) No. 4, "Measuring Pension Obligations and Determining Pension Plan Costs or Contributions." AFSCME represents 1.6 million state and local government, health care workers and retirees, who participate in over 150 public pension systems with assets totaling over $1 trillion. There is no group more interested in ensuring the strength of state and local retirement systems than the plan participants who are counting on those systems to provide retirement benefits.

State and local government retirement systems are governed by elected officials, appointed administrators and regulators, and independent boards of trustees. Plans are subject to stringent fiduciary, accounting, administrative, and investment standards, and regularly issue extensive financial and actuarial reports. AFSCME believes that existing statutes, accounting rules, and actuarial standards provide sufficient oversight and guidance in determining costs and necessary contributions for state and local pension plans.

According to the Government Finance Officers' Association, "The purpose of an actuarial valuation is 1) to determine the amount of actuarially determined contributions (i.e., an amount that, if contributed consistently and combined with investment earnings, would be sufficient to pay promised benefits in full over the long-term) and 2) to measure the plan's funding progress," The Role of the Actuarial Valuation Report in Plan Funding, available at http://www.gfoa.org/role-actuarial-valuation-report-plan-funding. Plan actuaries calculate, and report obligations based on a range of investment return assumptions consistent with the plan's asset portfolio. Actuaries also prepare reports of liabilities using applicable GASB standards. These calculations are designed to help plan sponsors, trustees, and elected officials determine contributions necessary to maintain the long-term health of the plan and to prepare public reports of pension funding.

AFSCME's main concern with the proposed revision to ASOP No. 4 is Section 3.11, "Investment Risk Defeasement Measure." The new measure states that "the actuary should calculate and disclose an obligation measure to reflect the cost of effectively defeasing the investment risk of the plan." This would require a calculation based either on a discount rate using United States Treasury yields or rates at which the pension obligation can be settled, perhaps by retaining a private insurer to pay benefits. In short, AFSCME believes this figure would be meaningless for public plans, as it is unrealistic when considering the typical plan's investment portfolio. The National Association of State Retirement Administrators (NASRA) reports an average 8.7 percent return on investment (ROI) for public sector plans over the past 30 years, https://www.nasra.org/files/Issue%20Briefs/NASRAInvReturnAssumptBrief.pdf.

In addition, state laws have been largely interpreted as prohibiting plan sponsors from freezing accruals in the manner of a private sector plan sponsor. In some cases, private plan sponsors may desire to "de-risk" their obligations to avoid Pension Benefit Guaranty Corporation premium payments, but public plan sponsors do not consider doing so because there are no PBGC payments and buying annuities through an insurance company is inefficient. Nor do public sector plan sponsors face the risk of going out of business as do private plan sponsors. It is also not clear that a public plan could eliminate its risk. For example, a state government would ultimately be responsible for paying benefits if a public plan sponsor outsourced its obligations to a private insurer and the insurer could not meet its obligation to plan participants and beneficiaries.

In short, the new IRDM figure would unrealistically exaggerate liabilities and would make many plans appear to be funded at untenably low levels. Defined benefit plan critics will describe the IRDM figure as the "true, risk-free cost" of providing benefits, and there is no doubt it will be used as part their ongoing attack on the retirement security of millions of American workers.

In recent years, the ROI has become a political football. Various commentators and academics have made provocative prognostications that bear no relationship to reality and have weaponized the ROI in the process. In our view, the "Defeasement Measure" is a misguided effort to take sides in the political debate and its adoption will serve to undermine the credibility and continued relevance of the ASB itself.

Respectfully,

Steven Kreisberg
Director
Department of Research and
Collective Bargaining

SK:jm

Brian B. Murphy
Gabriel, Roeder, Smith &Company
1 Towne Square
Suite 800
Southfield, MI 48076

July 30, 2018

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

Dear Actuarial Standards Board Members:

The plans that I currently serve as Actuary are all public plans. My comments, therefore, are entirely from that perspective. In addition, they are my own personal opinions.

Comments on Section 3.11 Investment Risk Defeasement Measure (IRDM):

If the IRDM is intended to be some type of quantification of risk, it belongs in ASOP 51. Our standards will look disorganized otherwise. If it is not intended to be a risk measure, then given the title of ASOP 4, I would have to conclude that it is a measurement of a pension obligation. In that case, I would suggest that it be renamed accordingly and perhaps redefined if necessary.

Getting into specifics, I find the definition of IRDM to be too prescriptive to be compatible with ASOP 1 Section 3.1.4. I think that because of the significant structural diversity of pension plans, particularly of public plans, the actuary needs much more flexibility in calculating an appropriate IRDM than the current ASOP 4 draft provides. Some particular points follow.

- I presume that, by "unit credit actuarial cost method", the drafters mean the Traditional Unit Credit method without salary projection "TUC". All of the plans that I work on are final average pay plans. The CCA White paper on funding policies classifies the TUC method as an unacceptable funding method for final average pay plans. I think most practitioners would agree with that classification. The public will find it contradictory that one actuarial body classifies a method as "unacceptable", while another mandates its use. In my opinion, the IRDM calculation as defined in ASOP 4 is, in the case of a final average pay plan, a hybrid between an ongoing plan calculation and a plan termination calculation. The application of funding assumptions in 3.11d is suggestive of a calculation related to an ongoing plan. The lack of salary projection is suggestive of a plan termination calculation. In other words, by mandating a calculation without salary projection, the ASOP is mandating inconsistent use of assumptions. It is likely that some users will view the IRDM as a plan termination calculation when it is not. Other users may think that it measures defeasement of accrued benefit investment risk when it does not (because most users at least in the public space conceive accrued benefits as being based upon final average pay).

- There are cases wherein the method specified in ASOP 4 for the IRDM calculation produces an incorrect result. The Wisconsin Retirement System has an optional variable annuity program. By statute, assets in the program are invested in a portfolio that is 100% common stock. Active members can invest a portion of their mandatory contributions in the variable program. At time of retirement, an individual's variable account value is annuitized at 5% interest and valuation mortality. By statute, retirees in the program receive annual benefit increases or decreases that are entirely dependent on the performance of the portfolio in which the assets are invested (again, by statute, it is a 100% equity portfolio). Investment return above a 5% threshold rate results in a benefit increase approximately equal to the percentage difference between the earned rate and 5%. Investment return below 5% results in a similarly calculated benefit reduction. (In fact, the benefit change is calculated based on the ratio of total retiree assets at market value to total retiree liabilities measured at 5%, which has the effect of pooling mortality experience). This plan has no significant investment risk because all investment results flow directly to the retirees. I think that the IRDM for such a plan should either be $0 or an undefined concept. I think that if I were to calculate the IRDM based on treasury yields, a positive and incorrect value for the IRDM would result. Furthermore, if the plan fiduciaries attempted to defease risk by investing in treasuries (although the statute does not permit that), the act of doing so would either change benefits or add investment risk. Retirees would be entitled to benefit changes based upon the difference between the treasury yield and the statutory portfolio yield.
- There can also be cases wherein the IRDM as defined in ASOP 4 is mathematically correct, but not appropriate given the facts and circumstances of the situation. It is common for an agent multiple employer plan to permit employers to withdraw from the plan. In many cases, liabilities for accrued benefits for retirees and existing employees remain with the plan, while future service benefits for existing employees, and all benefits for new employees, are covered by a replacement plan. In such cases, the actuary should be permitted to calculate an IRDM based upon conditions applicable to a potential withdrawal. Those conditions could differ from plan to plan. Agent Multiple Employer Plan A might freeze accrued benefits based on current pays when an employer withdraws, while Plan B might pay accrued benefits in the future based upon future pays but based upon service only up to the withdrawal date. In the Plan A situation, the IRDM as defined might produce a pretty good result. Regardless of the actual withdrawal liability that is charged to the withdrawing employer, the IRDM would inform all parties of the amount of investment risk that is involved. In the plan B situation, the IRDM as presently defined would be misleading and confusing. For example, in such a case, the IRDM might be calculated as $80 Million based upon frozen pays and other ASOP 4 methods, but the Plan B Actuary would want to report the IRDM as $100 Million based upon projected pays. Publishing both calculations would be confusing and misleading and could lead to disagreement between the plan and the withdrawing employer regarding the actual amount of the withdrawal liability. Therefore, the Plan B Actuary would want to omit the IRDM as defined in ASOP 4 from the report and replace it with a calculation that is more appropriate. I think therefore that the standard should permit the calculation to be based upon projected pay and other

assumptions and methods compatible with the operation of the plan, if, in the actuary's professional judgement, doing so is appropriate.
- I think that the actuary should be permitted to express the IRDM based upon the actuarial cost method used in the funding valuation. I think, in fact, that a calculation involving the present value of benefits (PVB) would provide a much more complete picture of risk than does the IRDM as currently defined.
- I recognize the pressure from the financial community to report a single measure of liability for all plans, the "MVL." Several rating agencies and various "Think Tanks" are already using various algorithms to calculate an approximation to a single measure, although I don't know that they are all marking to current interest rates. To the extent that unintended users of financial statements have a means of generating approximations to numbers that they either need or want, I don't see a need for a change in standards that requires the plan actuary to calculate a number for them, and the plan to pay for the calculation. If unintended users want an actual scientific IRDM calculation as opposed to an approximation, they could certainly engage an actuary to calculate one for them. A change in standard would not be required for that to occur.

In conclusion, I would like to see the IRDM requirement moved to ASOP 51 and defined in a principles-based manner in accordance with ASOP 51 Section 3.4.

Comments on Section 3.14 Amortization Method:

There are several problems with this section.

- As written, I think this section would not apply if someone other than the actuary selected the method. Is that the intention? Either way, clarifying language would be helpful.
- Section 3.14 as written would permit 100-year level $ funding of unfunded liabilities. Assuming that is not the intention of the drafters, some type of correction needs to be made. The problem seems to relate to the use of the word "or" in the third line.
- The section is probably intended to relate to amortization of unfunded liabilities, and not to amortization of surplus (i.e. of an overfunded liability). It should clearly say so. I don't think there is any need for the amortization of surplus to exceed nominal interest, for example. I think taking a credit of half the interest on surplus against the normal cost should be an acceptable method. Actually, I think that in many cases, surplus should be held as a reserve for adverse deviation and not used to reduce employer contributions.
- I think there can be circumstances in which an amortization schedule that calls for payments to increase more rapidly than payroll is not only acceptable, but necessary. For example, a poorly funded plan may need to ramp up contribution income rapidly in order to avoid insolvency, but it may not be possible for the plan sponsor to contribute at the ultimate rate in the first several years of the schedule. I don't see anything wrong with a contribution rate that increases faster than payroll for several years until it reaches an ultimate level, or even until the end of the amortization period. The plan will have more money in that case than if the rate increases at only the payroll growth rate for several years and then jumps to the ultimate level all at once. I am aware of one agent multiple employer plan that applies an

amortization schedule to severely underfunded agencies that decreases two years per year instead of one year per year. Because of the "should" language in Section 3.14, an actuary who believes that contributions need to increase faster than payroll in a particular situation would have to disclose that the recommendation to do so is a deviation from actuarial standards. Such disclosure could make it more difficult than it already is to get the needed funding from the plan sponsor. I also work for a cost sharing multiple employer plan that, by statute, require new employers entering the plan to pay off their initial liability based on a schedule of contributions that increases 5% per year. I don't see anything wrong with that either. Everyone knows and understands at the outset, what the deal is.

- The payroll in some plans can be a very small portion of the employer's total financial resources. For example, consider a State Highway Patrol plan with a $100 Million covered payroll in a state where the total payroll covered by all plans is $16 Billion. A requirement that contributions in such a plan increase no faster than the plan's covered pay seems unnecessary to me.
- Section 3.14 b. iii. seems to contemplate layered amortization bases. Consequently, Section 3.14 should explicitly say whether its requirements are to apply to each layer separately or to the sum of all layers. I don't think the latter is actually possible, so I think the former must be the intention of the drafters. The ASOP should be clear on this point.
- Section 3.14 seems to imply that all the bases have to be closed including gain loss bases. That should be made clear if it is the intention. Personally, I don't see a problem with a rolling gain loss base over a sufficiently short period and often suggest it as a simplification, particularly in agent multiple employer plans, wherein it might be necessary to track and explain tens of thousands of bases.
- In situations wherein there is a mix of credit and charge bases, a plan can have an unfunded liability and end up getting a credit against the normal cost due to the structure of the bases (or the opposite could occur). This appears to comply with Section 3.14, but I think that in many cases it is unreasonable, if not outright harmful. Permitting this in the ASOP could be a matter of reputational risk for the profession.

I am concerned that dealing with all of the above may result in an overly prescriptive ASOP that is not in keeping with ASOP 1, Section 3.1.4. One possibility might be to replace all of Section 3.14 with a simple statement along the following lines:

> *"If the actuary selects or recommends or applies an amortization method, the method should be compatible with the plan accumulating assets sufficient to pay benefits when due and it should fund the plan's unfunded liabilities within a reasonable period of time considering relevant facts and circumstances."*

Comments on Section 3.16 Output Smoothing Method:

I think that output smoothing, depending on how it is implemented, can be a preferred alternative to the use of asset smoothing, largely because output smoothing methods can be much more transparent to plans and their sponsors than asset smoothing methods. I think that output smoothing in conjunction with asset smoothing, which Section 3.16 seems to be intended to allow, is a complex issue. It is very easy for the combination to result in an excessive amount of smoothing that is not at all transparent to intended users. If the intention of this section is to allow the result of output smoothing to be termed an ADC, I think that it should only be permitted as an alternative to asset smoothing. If this suggestion is not taken, I would then suggest inclusion of a statement along the following lines:

> *"3.16 d. If the actuary selects an output smoothing method that is used in conjunction with asset smoothing, the actuary should consider whether or not the total amount of smoothing is reasonable."*

Comments on Section 3.19 Implications of Contribution Allocation Procedure or Funding Policy:

The exclusion for valuations that include a prescribed assumption or method set by law is new. I do not understand the reason for this exclusion. It seems to me that fiduciaries of private plans should also understand the implications of the funding policy.

Comments on Section 3.20 Reasonable Actuarially Determined Contribution:

The exclusion related to a prescribed assumption or method set by law basically excludes private plans from this requirement. In the unlikely event that a funding valuation for a private sector plan produced a result that was not a reasonable ADC, I would think that the fiduciaries would be well served by the disclosure of a reasonable ADC.

Regarding 3.20g, I believe that many public sector practitioners ignore the time lag between the measurement date and the contribution date when preparing funding valuations. This may be because doing so can be viewed as a relatively benign form of output smoothing. In periods when contribution rates are falling, ignoring the lag slows down the rate of decline. When rates are rising it slows down the rate of increase. I think that if a requirement to take the time lag into account is to enter the standard, a Practice Note on the subject would be helpful. There are several topics that would need to be addressed, including but not limited to:

- Contributions expected to be received between the measurement date and the contribution date.
- Recognition of assumed return during the period.
- The effect of the asset smoothing method, in other words, the effect of the unrolling of asset gain/loss bases during the lag period.
- Calculation of the Normal Cost and UAL contribution when more than one Plan Tier is involved. For example, suppose a plan has introduced a new tier and that on the measurement date there are no people in the new tier. By the time the contribution date arrives, there will be people in the new tier. What is the appropriate normal cost for the contribution period? Is it to be based solely on the old tier (perhaps with an interest adjustment), or is it based on some expectation of the proportion of people that will be in each tier on the contribution date?

Comments on Section 3.21 Gain and Loss Analysis:

The first sentence combines the word "should" with an "unless" clause. It would be simpler to replace "should perform" with "should consider performing" and dropping the "unless" clause. What is the intention of the drafters if a spread gain method is used in the valuation?

Thank you for considering my comments.

Sincerely

Brian B. Murphy FSA, EA, MAAA, FCA, PhD

NATIONAL EDUCATION ASSOCIATION
nea.org
Great Public Schools for Every Student

1201 16th Street, NW | Washington, DC 20036 | Phone: 202-833-4000

July 23, 2018

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

NSEA 150
GREAT SCHOOLS GOOD LIFE
1867-2017
JENNI BENSON
PRESIDENT
MADDIE FENNELL, NBCT
EXECUTIVE DIRECTOR
A member-directed union representing 28,000 public school teachers, faculty and education support professionals across Nebraska.

July 25, 2018

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

RE: Comments on the 2018 Proposed Revision of Actuarial Standard of Practice (ASOP) No. 4

The Nebraska State Education Association (NSEA) is deeply concerned that the Investment Risk Defeasement Measure (IRDM) proposal is technically inappropriate for public-sector funds and would lend credibility to the misrepresentations of our plans' liabilities. Given current attempts nationwide to end defined benefit public pensions, this is an important issue for our members.

The NSEA believes IRDM figures will be used to mislead people by presenting the numbers as the "true cost," including by individuals who served on the Society of Actuaries Blue Ribbon Panel on Public Pension Plan Funding, which has been cited as a reason to require the IRDM. As an example, the current funded ratio for our Nebraska School Employees Retirement plan is 86.7%, but under proposed IRDM calculations, this funded ratio drops to 57.2%.

Further, the IRDM is irrelevant to public-sector plans because it is illegal to "freeze and defease." Public retirement plans, such as the Nebraska School Employees Retirement System and the Omaha School Employees Retirement System, cannot be terminated based on salary at the termination date (as opposed to the salary at the retirement date), thus any liability measure which does not consider future expected pay increases would be underestimating the funding targets / liabilities of the plan.

The shortcomings of the IRDM as a practical measure of the cost to defease investment risk invite the question of why it has been proposed as a universal disclosure requirement, and whether the process that led to that proposed requirement is appropriate and consistent with the ASB's established methods and procedures for standard setting. ASOPs have never been narrowly prescriptive, so the ASB proposal would depart from the organization's practices.

For the above reasons, we recommend that the ASB rescind the IRDM disclosure requirement and allow practice to develop under the "purpose of measurement" guidance of ASOP Nos. 4 and 27 and the risk assessment guidance of ASOP No. 51.

Thank you for considering our responses.

Sincerely,

Jenni Benson
NSEA President

Maddie Fennell
NSEA Executive Director

Willis Towers Watson

July 27, 2018

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

Dear Sir or Madam,

This letter documents the response of Willis Towers Watson to the proposed revision of Actuarial Standard of Practice ("ASOP") No. 4 Measuring Pension Obligations and Determining Pension Plan Costs and Contributions, as requested in the Exposure Draft (ED) of March 2018.

Willis Towers Watson is a leading global professional services company that employs over 40,000 associates worldwide, over 1,100 of whom are members of U.S. actuarial bodies subject to the standards and approximately 600 of whom are enrolled actuaries. We provide actuarial and consulting services to more than 1,700 defined benefit plans in the U.S. The undersigned have prepared our company's response with input from others in the company.

Our comments generally support four central themes that we believe should apply to the ASOPs that can be found on our website at https://www.towerswatson.com/en/north-american-retirement-principles.

Summary and General Observations

Many of our comments note that the proposed requirements would entail significant additional work that would often not benefit the Principal. When additional analyses and disclosures are not helpful or requested, the actuary would not be compensated for the incremental effort imposed by ASOP No. 4. Such requirements would lead only to a more confusing work product and are not in the best interest of the profession.

We also observe that the requirements, other than ASOPs, that apply differ significantly among different areas of pension practice. Some pension plans, such as qualified U.S. plans in the private sector, are already subject to a vast array of funding rules and accounting requirements at both the plan and the corporate level. The standard proposed by the ED would introduce confusing and redundant analyses and disclosures for these plans. It would be more appropriate to provide exemptions for plans already subject to such governance. In this way, the ASOP would improve practice in areas without clear current guidance or requirements, but it would not impose superfluous requirements on others.

In addition, we believe that based on the definition of measurement date, the standard will be effective and apply immediately upon adoption to projections that are more than 12 months out. We recommend modifying the effective date provisions to avoid this result.

Willis Towers Watson
3001 Summer Street
Stamford, CT 06905

willistowerswatson.com

Towers Watson Delaware Inc.

We appreciate the opportunity to provide feedback. Our specific feedback on the ED follows, beginning with the two questions listed in the *Request for Comments* section of the ED.

Responses to Specific Requests for Comments

1. *Section 3.11, Investment Risk Defeasement Measure, requires the calculation and disclosure of an investment risk defeasement measure when the actuary is performing a funding valuation. The guidance allows for discount rates to be based upon either U.S. Treasury yields or yields of fixed income debt securities that receive one of the two highest ratings given by a recognized ratings agency. Are these discount rate choices appropriate? If not, what rate choice would you suggest?*

   As discussed in more detail in our comments on specific sections below, we do not believe that requiring the calculation and disclosure of an investment risk defeasement measure when the actuary is performing a funding valuation is appropriate. Additional risk assessments or measures may be "best practice" in some situations, but they are certainly not required for appropriate practice. In many situations such additional assessments would provide no benefit, not be desired by the Principal and result in uncompensated work for the actuary. Some such situations include when such measures are already provided for accounting purposes and when the plan is not material to the plan sponsor. Even if the additional measure would provide useful new information, we object to a broad requirement to include the measure as it will often lead to uncompensated work for the actuary that will not be valued by the Principal.

   While we do believe that the discount rate choices noted above would be appropriate for such a measure if adopted, we believe this disclosure already occurs in the accounting valuation for corporate pension plans. While we believe that this requirement should be eliminated, if adopted, we ask that the standard specifically state that separately provided financial reporting information determined under relevant accounting standards can be used to satisfy this requirement.

2. *Under certain circumstances, section 3.20, Reasonable Actuarially Determined Contribution, requires the actuary to calculate and disclose a reasonable actuarially determined contribution. Do the conditions in this section describe an appropriate contribution allocation procedure for this purpose? If not, what changes would you suggest?*

   We believe this section is redundant in that it simply refers to other sections of ASOP No. 4 and other ASOPs. For many pension plans, such as qualified U.S. pension plans in the private sector, the funding valuation includes many prescribed methods and assumptions set by law, making this section not applicable.

Specific Comments

***Section 3.3.2 (Uncertainty or Risk)* –** The ED added reference to ASOP No. 51 Assessment and Disclosure of Risk Associated with Measuring Pension Obligations and Determining Pension Plan Contributions. However, ASOP No. 51, section 1.2 (Scope) states that "this standard applies to actuaries when performing a funding valuation of a pension plan." Adding the reference to ASOP No. 51 into section 3.3.2 of the ED could be interpreted to extend ASOP No. 51's risk evaluation requirements beyond funding valuations, and the vagueness of section 3.3.2 exacerbates the problem. We suggest that the reference to ASOP No. 51 be deleted.

***Section 3.8 (Actuarial Assumptions)* –** The additions to this Section do not seem necessary and the guidance provided is not always appropriate. For example, an actuary might perform multiple funding or funded status projections some of which might include optimistic assumptions (such as showing the 75^{th} percentile results), which does not appear to be included in the concept of "adverse" deviation. Such analysis is a typical part of funding projections and should not represent a deviation from the requirement of ASOP No. 4. We suggest clarifying that the section does not apply to projections or adding "as appropriate" after the phrase about the combined effect of assumptions having no significant bias.

However, we also strongly believe the additions to this section are not needed, as we already have very comprehensive guidance on setting actuarial assumptions in other current ASOPs (No. 27 and No. 35) and potentially additional such guidance in upcoming ASOPs on modelling and assumption setting. We suggest no additions regarding assumptions be made to ASOP No. 4 to reduce redundancy, as it is burdensome for an actuary to have to refer to multiple ASOPs to ensure satisfaction of the guidance that relates to assumption setting.

Section 3.11 (Investment Risk Defeasement Measure) – We object to the addition of this requirement for the following reasons.

- For virtually all corporate qualified plans, such a measure already is provided routinely for accounting purposes and we see no reason to require an additional such disclosure for the funding valuation.
- The measure is not useful in a number of situations, including plans that are not material to the sponsor and plans that are overfunded using any reasonable set of assumptions
- The requirement places a burden on the actuary, imposing requirements for analyses that will often be beyond the scope of any agreement with the Principal, which the Principal may not need, and for which the actuary is unlikely to be compensated.

If such a disclosure is retained:

- We ask that this section explicitly state that measures and amounts used for financial reporting (e.g. the U.S. Generally Accepted Accounting Principles (GAAP) Accumulated Benefit Obligation measured at the most recent financial reporting date) may be used to satisfy this requirement. However, given that financial reporting already provides a measure very close to what is described in this section, we do not believe Section 3.11 is needed at all and we object to its addition.

- Section 3.11.d mentions that the actuary should calculate the investment risk defeasement measure using "assumptions other than discount rates used in the funding valuation or other reasonable assumptions based on estimates inherent in market data". We request clarification of what is meant by "market data" for some demographic assumptions such as retirement and termination rates, and would suggest removing the mention of market data since the actuary will rely on ASOPs No. 27 and No. 35 anyway in selecting assumptions. Otherwise we believe this sentence could be interpreted to imply completely separate assumptions from the funding or accounting valuations.

Section 3.13 (Actuarial Cost Method) – <u>Paragraph (c):</u> We suggest clarifying to say the requirement only applies to expenses that are paid from the pension trust.

Section 3.20 (Reasonable Actuarially Determined Contribution) – As discussed above in the Responses to Specific Requests for Comments section, we do not believe that this section is needed.

Section 3.21 (Gain and Loss Analysis) – We agree that the actuary should generally determine the gain/loss for each period, including separately determining the amount attributable to investments. In our view this represents basic professional standards. However, we do not believe that there should be any requirement to perform a detailed gain/loss analysis by source. We are concerned that some may interpret the Section to require this and try to impose that interpretation on actuaries. We recommend that Section 3.21 clearly state that a detailed gain and loss analysis by source is not required as such an analysis can be time consuming and expensive, may often yield only marginally more information than a higher level analysis and may not be wanted by the Principal. The actuary should apply professional judgement in determining how detailed an analysis to perform.

We suggest changing the phrase "successive gain and loss analyses would not be appropriate for assessing the reasonableness of the actuarial assumptions" to "successive gain and loss analyses would not be appropriate or necessary for assessing the reasonableness of the actuarial assumptions".

Section 4.1 (Communication Requirements) – Paragraph (l): The addition of this section requires an assessment of whether Prescribed Assumptions or Methods Set by Another Party are reasonable and consistent with other assumptions in accordance with section 3.8. However, section 3.8 does not have such a requirement, as it only refers to assumptions selected by the actuary. In addition, this requirement places an impractical burden on the actuary, imposing unreasonable requirements for analysis that will often be beyond the scope of any agreement with the Principal. Such analysis will typically be unwanted by the Principal and as a result the actuary would not be compensated for this analysis. We believe the actuary should not have to assess the reasonableness and consistency with other assumptions of assumptions that the actuary does not control (because law, regulations or accounting guidance give that responsibility to another party), other than to disclosure if they significantly conflict with what would be reasonable. If the Principal has a different future expectation from the actuary and chooses a different assumption, then as long as that assumption does not significantly conflict with what would be reasonable, the actuary should not have to affirmatively determine that it is reasonable or consistent with the other assumptions. See our similar comments on ASOP 27 and 35.

We suggest carving Assumptions Set by Another Party out of this requirement or, even more appropriately, deleting this requirement and leaving guidance on assumptions to ASOP No. 27 and 35.

Paragraph (u): As written, this would seem to require disclosure in a situation where a plan is in surplus by more than the normal cost and the allocation procedure results in $0 contribution. We do not believe this is appropriate and recommend that the provision be modified to avoid this result.

Paragraph (w): We object to the addition of this requirement. It would be needlessly burdensome to the actuary to describe how all seven considerations in section 3.17 have been taken into account in selecting each method of the contribution allocation procedure. Such new disclosures would often involve substantial additional work not requested by the Principal and for which the actuary would not be compensated. As indicated above in the Summary and General Observations, adding additional disclosures as indicated in section 4.1(w) only creates potential confusion for the Principal and clutters communications with boilerplate language.

Section 4.2 (Disclosure about Assumptions or Methods Not Selected by the Actuary) – Paragraph (a): This requirement added “individually or in combination with other assumptions or methods”. This change would require an analysis of whether a Prescribed Assumption or Method Set by Another Party that by itself does not significantly conflict with what would be reasonable nevertheless does significantly conflict with what would be reasonable when combined with any other methods or assumptions, regardless of who selected them. First, we believe that ASOP No. 4 is not the appropriate standard to deal with the choice of or internal consistency of assumptions. In addition, we believe that in many situations it will not be possible for the actuary to determine whether the combination of assumptions significantly conflicts with what would be reasonable when the individual assumption chosen by the other party does not For example, the actuary may not know the details of the analysis that went into selecting that assumption, or the assumption may be outside the actuary’s areas of expertise, or the effects of various future economic outlooks on other assumptions – for example, future disability or retirement rates – may not be clear). Similar to section 3.8, we object to this requirement for additional analyses that the actuary may not be qualified to perform, was not requested by the Principal, and for which the actuary will not be compensated. We believe the current requirement to disclose if the actuary believes the assumption significantly conflicts with what would be reasonable is sufficient.

Thank you for this opportunity to comment on the ED. If you have any questions concerning our comments, please contact us directly.

Sincerely,

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Comment #22 – 7/27/18 – 1:41 p.m.

Dear Members of the Actuarial Standards Board,

I write in support of the proposed changes to the pension actuarial standards of practice, ASOP 4, ASOP 27, and ASOP 35.

As background, I have spent my career researching and publishing on state and local government tax and fiscal issues and have spent much of the last five years researching the interplay between public pension plans and risks to government sponsors. Based upon modeling work that I have conducted with my colleague, Yimeng Yin, I have concluded that these risks are far greater than many policy makers realize. I have presented at numerous conferences and events on these topics (including at the 2017 Annual Meeting of the American Academy of Actuaries).

I support the expanded disclosure requirements (including the Investment Risk Defeasement Measure) contained within your proposals. These disclosures will improve the understanding of pension liabilities, costs, and risks by researchers and others seeking to develop a consistent outlook for public pension plans – which I hope will, in turn, contribute to an improved and more consistent financial outlook for state and local governments in general.

I also support the provisions specifically guiding actuaries to opine on legislated assumptions. I am always interested in understanding what actuaries think about prescribed assumptions.

Thank you very much for considering my views.

Sincerely,

Don Boyd

--

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Center for Policy Research
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July 27, 2018

Actuarial Standards Board
1850 M Street, NW, Suite 300
Washington, DC 20036

RE: Proposed Revision of Actuarial Standard of Practice No.4

Dear Members of the Board:

My career as an actuary spans more than fifty years, including insurance company administration and consulting, large-firm actuarial consulting and more than twenty-five years as an independent consulting actuary. I understand the needs of clients and practitioners covering nearly the entire pension landscape, from the largest to the smallest single employer plans, multiemployer plans, plan sponsors and participants. I have observed the evolution of pension funding and accounting since the dawn of ERISA in 1974 and FAS 87 in 1986 and through the myriad of subsequent law and FAS/ASC changes.

I write to oppose the adoption of proposed Section 3.11, Investment Risk Defeasement Measure, to be added to ASOP No. 4. This requirement is ill-conceived, so much so that I am compelled to write to the Board for the first time.

It is difficult to see how the required disclosure of an Investment Risk Defeasement Measure (IRDM) is fundamentally different from other liability measures already disclosed. Single employer plans presently determine the funding target using segment rates derived from yields on investment grade fixed-income corporate debt securities. Multiemployer plans disclose "current liabilities" measured using U.S. Treasury yields. If these measures satisfy the newly required disclosure under proposed Section 3.11, then what is the purpose of that section? If not, it begs the question of "Why is yet another measure of essentially the same liability needed?" If the currently determined values already satisfy the ostensible purpose of Section 3.11, the section should be discarded.

The exposure draft does not provide a rationale for including newly drafted Section 3.11. The Board should explain the reasons why an IRDM is required and separately disclosed. In particular, the Board should address why the implications of computing an IRDM could not be included in the assessment and disclosure of risk under ASOP No. 51.

Adding one more measure of liability will only confuse. Clients are already coping with a dizzying array of such measures of the same accrued benefits; e.g., plan termination liability, funding target for minimum funding, benefit obligation for accounting disclosures, annual funding notice disclosures, PBGC variable premium liability, current liability for full funding, lump sum present values under Code section 417(e), liability for measuring restrictions on distributions to "25-highest" employees, to name a few.

One must also consider the cost of calculating and reporting additional measures of liability and discussing those measures with clients and other users of actuarial reports. There is a clear difference in the efficacy of adding information to reports for small plans (and very small plans in particular) compared to large plans. Very small plans, such as plans of family-owned businesses and professional service employers are established for one purpose only, for tax efficient retirement savings. Imposing additional costs on these plan sponsors, and indeed all plan sponsors, for esoteric actuarial disclosures of marginal utility will inevitably lead to even more plan terminations. The number of changes in pension legislation, accounting rules and actuarial standards since ERISA defies reason and is a significant factor causing the death of defined benefit plans. In any event, at a minimum, the Board should waive the Section 3.11 disclosure for small plans.

Respectfully submitted,

Michael R Gerard

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July 27, 2018

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

Re: Comments on ASOP 4 Regarding IRDM

Members of the Actuarial Standards Board:

The attached comments were developed through the coordinated efforts of members of the Conference of Consulting Actuaries' (CCA) Public Plans Community and are being submitted to the ASB by the Steering Committee of the CCA Public Plans Community. However, these comments do not necessarily reflect the views of the CCA, the CCA's members, or any employers of CCA members, and should not be construed in any way as being endorsed by any of the aforementioned parties.

The members of the CCA Public Plans Community represent a broad cross section of public-sector actuaries whose extensive experience with public plans provides the framework for our response. The membership includes over 50 leading actuaries whose firms are responsible for cost and liability measurements for the majority of public sector retirement systems. We believe the overall response reflects a substantial consensus among the actuaries who provide valuation and consulting services to public pension plans.

Paul Angelo, FSA, FCA, MAAA, EA (By Direction)

Chair of the Public Plans Community on behalf of the Public Plans Community Steering Committee

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July 27, 2018

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

Dear Board Members:

We, the Steering Committee of the Public Plans Community of the Conference of Consulting Actuaries[1], have reviewed the recently released exposure draft of a proposed revision to Actuarial Standard of Practice (ASOP) No. 4, *Measuring Pension Obligations and Determining Pension Plan Costs or Contributions*. We offer the following comments on **Section 3.11** of the proposed standard:

1. For several reasons, we believe that the "Investment Risk Defeasement Measure" (hereinafter referred to as the "IRDM") as defined in Section 3.11 is seriously flawed as a generally applicable measure of investment risk:

    a. The proposed metric is to be based on the unit credit cost method, which for public sector retirement systems is rarely used for funding valuations and is never used for financial reporting valuations. This means that the IRDM presents these systems' liabilities – and hence their risks – in a fundamentally different way from the cost methods that they use for funding and financial reporting, all of which consider the effect of future salary increases on the liability attributed to participants' past service. As a result, the IRDM and the funding liability for a public retirement system will differ for reasons that have nothing to do with investment risk. We note that a more appropriate IRDM-style measure of investment risk is already found in Section 3.4 of ASOP No. 51 which states:

        "Methods may include, but are not limited to scenario tests, sensitivity tests, stochastic modeling, stress tests, and a comparison of an actuarial present value using a discount rate derived from minimal-risk investments *to a corresponding actuarial present value from the funding valuation* or pricing valuation" (emphasis added).

    b. We believe it is important for pension plan trustees to understand the implications and consequences of assuming investment risk, and we believe the most important measures to help them understand these implications and consequences are the stress tests, scenario tests, sensitivity tests and stochastic modeling described in ASOP 51. In contrast, as a measure of

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"investment risk," the IRDM is deficient in that it only attempts to assess the cost of avoiding investment risk. The cost of avoiding investment risk is only of practical interest to plan trustees once they have concluded that the implications and potential consequences may be unaffordable. Making the IRDM mandatory may actually undermine the importance of the measures described in ASOP 51 that quantify the implications and potential consequences of risk, none of which ASOP 51 mandates.

c. We note that many pension plans now contain plan design features that mitigate investment risk, such as establishing benefit accruals based on actual investment returns. The IRDM, as defined in the exposure draft, does not reflect such plan features, and so cannot assess the investment risk for such plans. The IRDM also cannot assess the risk of a pension plan that pays benefits through variable annuity contracts.

d. The IRDM, as its name suggests, focuses singularly on investment risk and not on other aspects of plan experience (e.g., improving longevity, retirements occurring earlier than projected using assumptions based on past experience due to unforeseen changes in sponsors' financial circumstances, etc.).This provides a decidedly narrow picture of a plan's risk that seems inconsistent with the more complete approach to risk assessment that is embodied in ASOP No. 51, *Assessment and Disclosure of Risk Associated with Measuring Pension Obligations and Determining Pension Plan Contributions.*

2. Additionally, the incorporation of the IRDM in the exposure draft as a required disclosure in all actuarial valuations presents a number of problems in terms of consistency with the operating policies of the Actuarial Standards Board and with other standards it has promulgated.

a. In requiring disclosure of a metric using particular methods and assumptions, the Actuarial Standards Board is deviating in a significant way from the principle that Standards of Practice should be principles-based rather than prescriptive in defining appropriate actuarial practice. The proposed requirements of Section 3.11 are in direct conflict with ASOP 1, Section 3.1.4 which says:

> "The ASOPs are principles-based and do not attempt to dictate every step and decision in an actuarial assignment. Generally, ASOPs are not narrowly prescriptive and neither dictate a single approach nor mandate a particular outcome. Rather, ASOPs provide the actuary with an analytical framework for exercising professional judgment, and identify factors that the actuary typically should consider when rendering a particular type of actuarial service. The ASOPs allow for the actuary to use professional judgment when selecting methods and assumptions, conducting an analysis, and reaching a conclusion, and recognize that actuaries can reasonably reach different conclusions when faced with the same facts."

b. In our opinion, a robust examination of investment risk – or any other risk – faced by a pension plan most logically belongs in ASOP No. 51, *Assessment and Disclosure of Risk Associated with Measuring Pension Obligations and Determining Pension Plan Contributions.* In fact, ASOP No. 51 already contains principles-based guidance to evaluating pension plans' investment risks. ASOP No. 51 appropriately does not prescribe one method for assessing risk and instead suggests various methods for assessment of risk that focus on possible outcomes, including scenario tests, stress tests and stochastic modeling. Any of these would be more generally applicable than the proposed theoretical cost to defease a plan's investment risk.

c. ASOPs Nos. 4, 27 and 35 emphasize that a primary consideration in the selection of actuarial methods and assumptions is the purpose of the measurement. The discount rates mandated for use in the calculation of the IRDM do not produce a number that is useful in assessing and managing ongoing investment risk. Moreover, the mandated use of the unit credit (i.e., accrued benefit) cost method, together with the use of current market interest rates, implies that the most useful and commonly understood purpose of the IRDM is as an estimate of the cost of settling the obligation for accrued benefits, and not as an investment-risk measure.[2]

Identifying the primary purpose of the IRDM as a settlement measure is important because it limits its relevance, particularly for public sector retirement systems. In many jurisdictions in the United States it is legally impermissible, outside of bankruptcy, for public retirement systems to freeze benefit accruals or to settle obligations in the manner represented by the IRDM calculation. The presentation of such a metric in actuarial reports prepared for such retirement systems would immediately incur the risk of misuse and/or misinterpretation by others. This could present a significant burden for actuaries signing such reports in terms of their responsibilities under Precept 8 of the *Code of Professional Conduct* and create more general reputational risk problems for the actuarial profession.[3]

For these reasons, the ASB should remove the requirement that the actuary "should calculate and disclose" any such settlement metric – by whatever name – as part of an ongoing funding valuation. At most the guidance should state that the actuary "should consider calculating and disclosing" such a value. Furthermore, if any "should calculate and disclose" guidance is retained it should apply only for plans where there is an established practice and procedure for engaging in a settlement transaction and only for those plan sponsors for whom the retirement system's legal framework allows for such settlements.

3. Finally, we urge the ASB to acknowledge that the IRDM, in addition to being a settlement measure, is also the value known in the financial economic literature as the "Solvency Value"[4], and to consider the policy implications of making that value a universally required disclosure.

   a. We recognize that the disclosure of the IRDM would satisfy the demands of some readers of actuarial reports, who find that solvency/settlement-type values are useful for their purposes. However, these entities have demonstrated that they can produce estimates of such settlement values for their purposes independently. We believe that it is preferable for them to continue to do so, as they are neither principals nor intended users of the valuation actuary's work product.

   b. We remind the ASB that in 2008 the ASB was asked by the American Academy of Actuaries to "develop standards for consistently measuring the economic value of pension plan liabilities" (here "economic value" is another term for the solvency/settlement value). After an exhaustive

[2] The functional purpose of the IRDM as a settlement measure also calls into question the guidance in Section 3.11(d), which says the IRDM should use the same demographic assumptions as used in the funding valuation. In practice, settlement values often should use different demographic assumptions, specifically retirement rates, to reflect the curtailment of future benefit accruals.

[3] Even in a bankruptcy proceeding, the presentation of a settlement value could affect the outcome of the bankruptcy process in a way that is both unnecessary and unintended, and result in a settlement more extreme than is called for by the facts and circumstances.

[4] A common reference for this is the "Pension Actuary's Guide to Financial Economics," Joint AAA/SOA Task Force on Financial Economics and the Actuarial Model, 2006. In addition, the February 2016 "Report of the Pension Task Force of the Actuarial Standards Board" refers to the IRDM as the Solvency Value. Note we are not proposing that the ASB use the Solvency Value terminology, but only that you acknowledge that this is an established purpose for the value defined as the IRDM in the Exposure Draft.

review of ASOPs Nos. 4 and 27, the ASB in 2013 declined to develop such standards, choosing instead to focus on the "purpose of the measurement". We understand that the ASB may now feel it is appropriate to provide such guidance, and we believe the IRDM as defined would fulfill the Academy's request in most circumstances. However, the Academy specifically did not ask the ASB to require disclosure of a solvency/settlement value. We concur with that Academy position and urge the ASB to limit its new guidance to defining a solvency/settlement value, without requiring its disclosure.

c. Finally, we urge the ASB to consider that requiring a solvency/settlement value disclosure characterized as a risk measure will itself incur a reputational risk for the profession. As discussed above, the IRDM is of questionable value taken solely as a risk measure. This impairs the credibility of the proposed standard – and by extension all actuarial standards -- because the IRDM's limited merits as a risk measure cannot justify its required disclosure in all pension valuations. As plans realize and then explain to stakeholders that the disclosure is required by the ASB but is of limited practical value for their plans, the value of other required disclosures may also be questioned and the credibility of the ASB and the ASOPs may suffer.

For these reasons, we urge the ASB to confine its guidance to defining a solvency/settlement value, and leave its disclosure to the professional judgement of the valuation actuary. As noted above, the only situation where it might be appropriate to require such a disclosure would be where settlement is an established practice, in which case the disclosed value should be the actual settlement value determined under the terms of the plan.

We appreciate the opportunity to provide feedback on the proposed revisions to ASOP No. 4 and would be happy to discuss our comments in greater detail.

Sincerely,

Members of the Conference of Consulting Actuaries Public Plans Community Steering Committee

Paul Angelo, Chair
Thomas B. Lowman, Vice Chair
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July 27, 2018

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

Re: Comments on ASOP 4 Regarding ADC

Members of the Actuarial Standards Board:

The attached comments were developed through the coordinated efforts of members of the Conference of Consulting Actuaries' (CCA) Public Plans Community and are being submitted to the ASB by the Steering Committee of the CCA Public Plans Community. However, these comments do not necessarily reflect the views of the CCA, the CCA's members, or any employers of CCA members, and should not be construed in any way as being endorsed by any of the aforementioned parties.

The members of the CCA Public Plans Community represent a broad cross section of public-sector actuaries whose extensive experience with public plans provides the framework for our response. The membership includes over 50 leading actuaries whose firms are responsible for cost and liability measurements for the majority of public sector retirement systems. We believe the overall response reflects a substantial consensus among the actuaries who provide valuation and consulting services to public pension plans.

Paul Angelo, FSA, FCA, MAAA, EA (By Direction)

Chair of the Public Plans Community on behalf of the Public Plans Community Steering Committee

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July 27, 2018

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

Dear Board Members:

We, the Steering Committee of the Public Plans Community of the Conference of Consulting Actuaries[1] (CCA PPC), have reviewed the recently released exposure draft of a proposed revision to Actuarial Standard of Practice (ASOP) No. 4, *Measuring Pension Obligations and Determining Pension Plan Costs or Contributions*. This letter presents our comments on **Sections 3.14 through 3.20** of the proposed standard. Those sections contain guidance related to an actuarially determined contribution (ADC) and to the components of the contribution allocation procedure (CAP) used to calculate the ADC.

As the ASB should be aware, the CCA PPC had done considerable work reviewing and refining the development of CAPs for public sector retirement plans. The results of that effort are found in the CCA PPC "White Paper", "Actuarial Funding Policies and Practices for Public Pension Plans", published in October 2014.[2] The White Paper includes a comprehensive discussion of policy and design considerations related to each of the three elements of a CAP: actuarial cost method, asset valuation method and amortization method for any unfunded actuarial accrued liability (UAAL). It also includes a discussion of some output smoothing methods, which it calls "Direct Rate Smoothing".

We believe the identification and discussion of considerations related to amortization methods and output smoothing methods found in the White Paper will be helpful to the ASB as it deliberates new guidance in these areas, and we will refer to those discussions in our comments below.

1. **Section 3.14 and Sections 4.1(s) and (u) of the exposure draft relate to amortization methods**. We offer the following comments on this section:

    a. While its guidance is stated in the positive, we believe the intent of Section 3.14 is to preclude amortization methods that combine "negative amortization" (where the payments do not cover

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[2] https://www.ccactuaries.org/Portals/0/pdf/CCA_PPC_White_Paper_on_Public_Pension_Funding_Policy.pdf

assumed interest on the UAAL[3]) with "rolling amortization" (where the UAAL amortization period is reset at the same duration at each measurement date). We concur with this result, but suggest that result would be clearer if those alternative conditions were presented in separate subsections.

b. The ASB should be aware that even with no negative amortization, rolling amortization can still take a very long time to materially reduce the UAAL. For example, under typical salary growth and interest assumptions, 15-year rolling amortization will not result in negative amortization but will still take over 30 years to reduce a UAAL base to one-half of its original amount. For that reason we recommend that the "reasonable time period" considerations in Sections 3.14(b) i through iv should apply to all amortization methods, with an additional consideration for rolling methods that do not fully amortize the UAAL. This is another reason why it would be clearer to have the "exceed nominal interest on the UAAL" condition as a separate subsection.

c. To summarize these two comments, we recommend restructuring Section 3.14 so that the amortization payments must either (a) exceed nominal interest or (b) fully amortize the UAAL in a reasonable period (and not increase faster than expected payroll). Then the considerations and conditions on reasonable amortization periods should apply to all amortization methods, with a specific consideration for methods that do not fully amortize the UAAL.

d. Section 3.14 should explicitly accommodate the use of "layered" amortization bases, where each change in UAAL is amortized separately. We note that the use of layered amortization bases is anticipated in the disclosure required under Section 4.1(s). Under layered amortization, different bases will be fully amortized at different valuation dates. When a "charge" base (e.g., an actuarial loss) is fully amortized the total (i.e., net) amortization payment decreases while when a "credit" base (e.g., an actuarial gain) is fully amortized the total amortization payment increases. This means that when a credit base is fully amortized, the total amortization payments could fail the conditions of 3.14(a) even though the payments towards each amortization base meet those conditions. We suggest modifying section 3.14 to state that for plans using a method with layered amortization bases, the guidance in that section applies to each base individually rather than to the total amortization payment.

e. The exposure draft does not appear to address amortization of "surplus", where assets exceed the actuarial accrued liability. Amortizing surplus results in an ADC less than normal cost. The CCA PPC White Paper has a detailed discussion of surplus amortization and concludes that the preferred policy is long, rolling amortization of surplus, just the opposite of UAAL amortization. Even if the ASOP does not give guidance specific to surplus amortization, it should make clear that the constraints in Section 3.14 apply only to UAAL amortization, and not to surplus amortization.

2. **Section 3.16 of the exposure draft, along with the definition in Section 2.18, provide guidance related to output smoothing methods.** We agree that the ASB should provide guidance on output smoothing methods. We also agree that the guidance should be similar in structure to the guidance on asset valuation methods, and on asset smoothing methods in particular, found in Section 3.3 of ASOP No. 44, as is the case in Section 3.16 of the exposure draft. However, there is a wider range of output smoothing methods in use, particularly among public pension plans, than for asset

[3] Consistent with Section 3.14(a), negative amortization only occurs with level-percent-of-pay amortization over relatively long periods.

smoothing methods. For that reason, the standard may need to make some differentiations among different types of output smoothing methods and develop its guidance accordingly.

Our comments hope to assist in that effort, and admittedly appear complicated. We would briefly summarize them as follows:

- Incorporate the alternative "sufficiently" conditions from ASOP No. 44 into this Section 3.16.
- Provide specific guidance for phasing in the impact of an assumption change on contributions, even when it is applied in addition to asset smoothing.
- For other output smoothing methods, distinguish those applied *instead of* asset smoothing from those applied *in addition to* asset smoothing.
- Generally, subject to conditions analogous to Section 3.3 of ASOP No. 44, the former ("instead of") should constitute a reasonable ADC under Section 3.20 while the latter ("in addition to") should not constitute a reasonable ADC unless the ADC without such output smoothing is also disclosed.

Note that our comments are consistent with pages 28-29 of the CCA PPC White Paper, which provides a brief discussion of output smoothing methods, and where they are called "Direct Rate Smoothing" methods.

a. Before considering different types of output smoothing, we have a comment on the conditions found in Section 3.16. As noted above, the conditions in Section 3.16 parallel the conditions of Section 3.3 of ASOP No. 44 applicable to asset valuation methods, specifically asset smoothing methods. However Section 3.3 also allows that asset smoothing methods that return to market value in a sufficiently (rather than reasonably) short period of time or stay within a sufficiently (rather than reasonably) narrow range of market value only need to meet one of those conditions. This is an important feature of ASOP No. 44 that we believe should be incorporated into Section 3.16 of ASOP No. 4.

   We also note that the intended references to "ADC without output smoothing" are not consistent, and the words "without output smoothing" should be added at the ends of subsections 3.16(a) and 3.16(c).

b. As observed in the White Paper, at least in public pension practice, output smoothing methods fall into two broad categories. Some are included as a component of a CAP *instead* of an asset smoothing method, while others are applied to the results of a CAP that *already includes* an asset smoothing method. Because we believe ASB should consider whether its guidance should distinguish between these two types of output smoothing, we will comment on them separately.[4]

c. For output smoothing methods that are applied instead of asset smoothing, while the White Paper is silent on such methods, we believe that ASOP guidance analogous to Section 3.3 of ASOP No. 44 is both appropriate and sufficient. Such methods generally determine an ADC based only on a cost method and an amortization method (i.e., using a UAAL based on the

[4] Note for example that in the examples in Section 2.18, the amount of smoothing added under example 2 (blending) and example 3 (corridor) will vary considerably depending on whether these techniques are applied after asset smoothing or instead of asset smoothing.

market value of assets) and then apply either the blending method or the corridor method from the examples in Section 2.18. For these plans, the "ADC without output smoothing" referenced in Section 3.16 is the market value based ADC and the application of the conditions in Section 3.16 would be similar in result to the application of ASOP No. 44 to an ADC that incorporates asset smoothing.

A different version of this type of "output smoothing in lieu of asset smoothing" was recently developed by CalPERS and adopted by some municipal systems. It mimics the results of asset smoothing by building a ramp-up and ramp-down into the amortization payments themselves. Here again we believe that ASOP guidance analogous to Section 3.3 of ASOP No. 44 is both appropriate and sufficient. While the determination of the "ADC without output smoothing" referenced in Section 3.16 is not as straightforward, we believe actuaries using this method will be able to do so in a manner consistent with the intent of the guidance.

For plans using these methods (and complying with the conditions of Section 3.16) the ADC including output smoothing would be a reasonable ADC under Section 3.20, and there would be no requirement to disclose the ADC without output smoothing. This is analogous to the fact that ASOP N0. 44 does not require disclosure of an ADC without asset smoothing, i.e., based solely on the market value of assets.

d. With one important exception[5], for output smoothing methods that are applied in addition to an asset smoothing, the discussion in the CCA PPC White Paper leads to their categorization as non-recommended practices. To summarize that discussion, well-designed asset smoothing and amortization methods provide a reasonable balance between intergenerational equity and contribution stability without the additional output smoothing. Accordingly we believe that, with the one exception described in our next comment, an ADC including both asset smoothing and output smoothing should not satisfy the conditions set for a reasonable ADC under Section 3.20. More specifically, plans using such methods should also disclose the ADC without such output smoothing as the reasonable ADC defined under Section 3.20. [6]

   As a simpler and less restrictive alternative, an ADC including both asset smoothing and output smoothing could be considered reasonable under Section 3.20, assuming compliance with Section 3.16. In that case, we would recommend adding to Section 4 a requirement to disclose the ADC without such output smoothing. As discussed above, this disclosure requirement should not apply to an ADC that incorporates output smoothing *instead of* asset smoothing.

   Note that under either of these approaches the conditions of Section 3.16 would involve a comparison between the ADC with and without output smoothing, while Section 3.3 of ASOP No. 44 involves a comparison of the market and smoothed asset values. For an ADC that includes both asset and output smoothing the standard may want to include consideration whether the combined amount of smoothing is reasonable. Alternatively, the general conditions of Sections 3.18 and 3.19 may be adequate to address this concern.

[5] We believe that example 1 of Section 2.18, phasing in the impact on contributions of a change in assumptions, is materially different from other types of output smoothing and so will be discussed separately.

[6] At the risk of confusing things even further, any output smoothing method should still be required to be reasonable under Section 3.16, even if its use in conjunction with asset smoothing leads to an ADC that is not considered reasonable.

e. The first example of an output smoothing method in Section 2.18 is phasing in the impact on contributions of a change in assumptions. Subject to the conditions of Section 3.16, an ADC that includes this component this should be considered reasonable even if that ADC also includes asset smoothing. This is in contrast to our recommendations related to the other examples in Section 2.18.

   This particular type of output smoothing is discussed in the CCA PPC White Paper. There it is considered an acceptable practice, even in combination with asset smoothing, as long as the phase in period ends before the next expected review of actuarial assumptions (but no longer than five years). While we believe the guidance in Section 3.16 would arguably lead to this same constraint on the phase in period, that condition could be made more explicit specifically for this type of output smoothing.

   Phasing in the impact on contributions of a change in assumptions is reasonable even in combination with asset smoothing because assumption changes occur less frequently than actuarial valuations. For many public systems, experience studies are performed on a regular schedule, generally every three to five years. If there is no phase in of assumption changes, such plans (using three years as an example) will have relatively stable contributions for three year periods, with a discontinuity following the experience study. A three year phase in simply exchanges each of these larger triennial contribution changes for three equal annual changes.

   Finally, we should note our strong preference for phasing in the contribution impact of an assumption change rather than phasing in the assumption change itself. While we are not submitting comments on the exposure drafts of ASOP Nos. 27 and 35, we have some concern that the proposed guidance there on phasing in assumptions may give that practice more of an endorsement than is either intended or desirable.

3. We offer the following comments pertaining to both **sections 3.14 and 3.16 regarding who selects the amortization method or the output smoothing method**:

   a. The new sections 3.14 and 3.16 begin with the phrase "If the actuary selects..." Although the actuary may give advice on the selection of an amortization method or output smoothing method, the plan sponsor or the governing body of the plan may actually select the method. For amortization methods, if the method selected is not in compliance with section 3.14, it appears that the actuary would need to disclose an alternative under 3.20. For output smoothing, the actuary's assignment may end at the determination of the ADC without any output smoothing, with the plan sponsor subsequently applying an output smoothing method. We ask the ASB to clarify the meaning of the actuary selecting these methods in the context of methods set by another party (but not prescribed by law).

4. **Section 3.20 of the exposure draft relates to a reasonable actuarially determined contribution (ADC).** We support the disclosure of a Reasonable ADC in all funding valuations, which is consistent with this statement from page 6 of the CCA PPC White Paper:

   Some pension plans have contributions rates that are set on a fixed basis, rather than being regularly reset to a specific, actuarially determined rate. The CCA PPC believes that such plans should develop an actuarially determined contribution rate for comparison to the fixed rate.

While we have provided comments on the detailed guidance in sections 3.14 and 3.16 above, we note that those rules clearly move in the direction of more prescriptive guidance. Furthermore, making adjustments (such as found in our comments) to accommodate practices that are reasonable while restricting practices that are not reasonable leads to even more prescriptive rules. As an alternative, we suggest that those detailed rules may not be needed if a reasonable ADC is simply specified in Section 3.20 as one that satisfies the following two principles-based conditions:

1. The ADC is either currently greater than normal cost plus interest on the UAAL (measured on the market value of assets) or is expected to be greater within a sufficiently short time period, and
2. The ADC is expected to fully amortize the UAAL (not surplus) or come within a sufficiently narrow range of full amortization within a reasonable time period.

As long as the ADC complies with these two principles-based conditions, the standards need not and should not specify the details of the amortization method, the asset smoothing method, or the output smoothing method. Practice notes and white papers are more appropriate for providing specific advice on how to develop the components of such a reasonable Contribution Allocation Procedure, consistent with these two conditions.

We appreciate the opportunity to provide feedback on the proposed revisions to ASOP No. 4 and would be happy to discuss our comments in greater detail.

Sincerely,

Members of the Conference of Consulting Actuaries Public Plans Community Steering Committee

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July 27, 2018

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

RE: ASB COMMENTS

Dear Sir/Madam:

The Segal Group (Segal) is pleased to comment on the exposure draft of a proposed revision of ASOP No. 4, *Measuring Pension Obligations and Determining Pension Plan Costs or Contributions*. Segal is a major consulting firm providing actuarial services to all types of pension plans, with special expertise in the multiemployer and public sector areas. We have identified several concerns and places where further revisions would clarify the requirements and improve their practicality (make them easier to satisfy), while maintaining the spirit of the principles included in the proposed revision.

Our comments include responses to the questions asked in the cover memo as well as comments on specific sections of the exposure draft.

Responses to Questions

Our responses to the questions asked by the ASB are shown below:

1. Section 3.11, Investment Risk Defeasement Measure, requires the calculation and disclosure of an investment risk defeasement measure when the actuary is performing a funding valuation. The guidance allows for discount rates to be based upon either U.S. Treasury yields or yields of fixed income debt securities that receive one of the two highest ratings given by a recognized ratings agency. Are these discount rate choices appropriate? If not, what rate choice would you suggest?

   We believe that ASB should clarify the purpose of this measure, as in many situations investment risk cannot be "defeased" in any practical sense, and there is widespread concern with possible misuse of this measure. Please see our expanded comments below on section 3.11. As to the specific questions posed, we believe that the standard should be less prescriptive, so that additional choices are available.

2. Under certain circumstances, section 3.20, Reasonable Actuarially Determined Contribution, requires the actuary to calculate and disclose a reasonable actuarially determined contribution. Do the conditions in this section describe an appropriate contribution allocation procedure for this purpose? If not, what changes would you suggest?

   We support the requirement for this calculation and disclosure. However, as discussed in our comments on section 3.20(b), we believe that certain potential restrictions on the actuarial cost method are not needed in light of restrictions on the **contribution allocation procedure.** See also proposed language below in section 3.14 on **amortization methods**.

Comments on Specific Sections of the Exposure Draft of the Proposed Revision

Our detailed concerns with respect to the exposure draft of the proposed revision include the following:

- Section 2: Definitions

  To be consistent with **market-consistent present value**, and because this would be a major change that many plans and actuaries find challenging and unnecessary, we suggest that **investment risk defeasement measure (IRDM)** be defined in section 2. The first sentence of the definition could be "An obligation measure that reflects the cost of effectively defeasing the investment risk of the plan." As discussed below with respect to Section 3.11, more guidance is needed on the purpose of this measurement; that purpose should also be expressed in the definition (as for example is the case with the Section 2.11 definition of **funding valuation**). Section 3.11 would then start as follows: "If the actuary is performing a funding valuation, the actuary should calculate and disclose an **investment risk defeasement measure**."

  Throughout this exposure draft, we found the interconnections among **contribution allocation procedure**, **output smoothing method**, and **actuarially determined contribution** confusing, especially since "The **output smoothing method** may be a component of the **contribution allocation procedure** or may be applied to the results of a **contribution allocation procedure**." We suggest that what is intended in different sections of the proposed standard could be made clearer if a new term, **smoothed contribution**, is defined. The definition could be "A potential payment to the plan as determined after applying an **output smoothing method** to the **actuarially determined contribution**. It may or may not be the amount actually paid by the plan sponsor or other contributing entity." This definition parallels the definition of **actuarially determined contribution** and, as discussed below, would make the language in section 3.16 and other places easier to understand.

  In addition, it may be clearer if **actuarially determined contribution** is defined without reference to an **output smoothing method**. For the purpose of these comments, we have not assumed any change in its definition but please consider whether such a change would improve the clarity of the ASOP.

- Section 2.12: The definition of a **Funding Valuation** might be interpreted to include a benefit payment projection provided by the actuary for a SERP that is funded on a pay-as-you-go basis. We do not believe that this was intended, nor is this appropriate. This should be clarified.

- Section 2.18: The definition of **output smoothing method** in the exposure draft is limited to a **contribution allocation procedure**, but this should also apply to a **cost allocation procedure** (Section 2.9) for purposes of determining a **periodic cost**.

  This definition also includes several references to “contributions.” This is inconsistent with the definition of **contribution allocation procedure** and its references to an **actuarially determined contribution**. An **actuarially determined contribution** is a “potential payment to the plan…It may or may not be the amount actually paid by the plan sponsor or other contributing entity.” We suggest that the language be changed to reference either the **actuarially determined contribution, periodic cost,** or “a potential payment to the plan.”

- Section 3.11: Further to the comment in Section 2 above (the proposed addition of a definition of **investment risk defeasement measure),** the proposed standard does not provide clear guidance to the actuary on the purpose of calculating the investment risk defeasement measure; this is especially of concern when the investment risk cannot be “defeased” in any practical sense, given statutory or market constraints.

  The ASB should provide a better rationale for this measure, enabling the actuary to clarify what it represents, and what it does not represent. Many believe that the measure will provide information on the amount of investment risk being taken by the plan; however, for some plans there will be no comparable obligation measure to evaluate that particular level of risk. For instance, many public sector plans do not otherwise calculate a measurement of the benefits accrued to date under the unit credit liability method. If the purpose is as just described, to provide internal comparability the standard should allow the defeasement measure to be determined as the actuarial accrued liability based on the cost allocation method being used to fund the plan.

  Given widespread concerns in the public plans sector with possible misunderstanding and misuse of the defeasement measure, by both intended users and other parties (see Precept 8), the standard should:

  - encourage, if not require, some type of disclosure about the purpose of the measure and to further acknowledge (if appropriate) that the investment risk cannot be defeased.

  - consider whether to allow this disclosure to appear in a side letter provided to all intended users, rather than in the main body of the actuarial report on the results of the funding valuation, to allow for a full explanation of the measure and its limitations.

We also believe that, if the ASB is intent on retaining this section, it should be far less prescriptive and take into account the possibility of using other approaches that in the actuary's professional judgment are consistent with the purpose of this measurement. This revision could potentially reduce both the amount of additional work required and the possibility of confusion for the user. One approach to implementing this suggestion would be to revise the end of (c) along the following lines.

"Examples of discount rates that the actuary could use include:

1. U.S. Treasury yields;

2. "Current Liability" discount rates;

3. rates at which the pension obligation can be effectively settled. The actuary may use yields of fixed-income debt securities that receive one of the two highest ratings given by a recognized ratings agency;

4. rates published by the PBGC for plan terminations;

5. non-stabilized HATFA (ERISA single-employer funding) corporate bond segment rates; or

6. rates implicit in an annuity purchase quote from an insurance company."

Finally, if the pension plan has investment risk-sharing features (e.g., variable annuity, benefits linked to a market index, etc.), then the assumed discount rate and the economic assumptions underlying the assumed benefits payable should be consistent in accordance with ASOP No. 27, Section 3.12. An investment risk defeasement measure may not be meaningful for a true variable pension plan, and may have limited application to other designs with investment-risk sharing features. Additional guidance to the actuary would be useful for these situations.

- Section 3.11(d): We found this subsection to be confusing. We suggest the following, structured to be more parallel with the language in section 3.10:

  "d. assumptions other than the discount rates described in 3.11(c) should be reasonable assumptions that, in the actuary's professional judgment, are either those used in the **funding valuation** or those based on the actuary's observations of the estimates inherent in market data, or a combination thereof, in accordance with the guidance in ASOP Nos. 27 and 35 and taking into account the purpose of the measurement."

- Section 3.14: We believe that an **amortization method** selected by the actuary should <u>always</u> be designed to fully amortize the unfunded **actuarial accrued liability** within a reasonable time period. We think this is especially important given the new requirement to calculate and disclose a **reasonable actuarially determined contribution**. We therefore suggest that this section be revised along the following lines:

> "If the actuary selects an **amortization method**, the actuary should select an **amortization method** that fully amortizes the unfunded **actuarial accrued liability** within a reasonable time period and that meets at least one of the following conditions:
>
> a. the payments do not increase;
>
> b. the payments do not increase more rapidly than expected covered payroll; or
>
> c. the payments exceed nominal interest on the unfunded **actuarial accrued liability**.
>
> For purposes of determining a reasonable time period, the actuary should consider factors such as the following:
>
> i. the length of time until amortization payments exceed nominal interest on the unfunded **actuarial accrued liability**;
>
> ii. the duration of the **actuarial accrued liability**;
>
> iii. the source of the unfunded **actuarial accrued liability** or change in the unfunded **actuarial accrued liability**; and
>
> iv. the **funded status** of the plan or period to plan insolvency, if applicable."

We also note that the cost methodology used to determine annual accounting expense under U.S. GAAP (FASB ASC 715) may not meet the conditions of this section (e.g., due to the standard gain/loss corridor or due to different interest rates on liabilities vs assets), leading to a position that the methodology is unreasonable. Since these requirements only apply when the actuary selects the methods, this may not affect a plan that is subject to GAAP. Please clarify whether the actuary would be able to select the GAAP methodology to develop an annual cost for a plan that is not subject to GAAP.

- Section 3.16: We suggest that the wording of this section be clarified to take into account the proposed definition of **smoothed contribution**. We note that further clarification could be achieved if the definition of **actuarially determined contribution** were changed to exclude reference to an **output smoothing method**. In the absence of that latter change, the wording could be as follows:

> "If the actuary selects an **output smoothing method**, the actuary should select an **output smoothing method** that results in a reasonable relationship between the **smoothed**

contribution and the **actuarially determined contribution** (prior to the application of any **output smoothing method**). A reasonable relationship includes the following:

a. **the output smoothing method** produces a **smoothed contribution** that falls within a reasonable range around the corresponding **actuarially determined contribution** (prior to the application of any **output smoothing method**);

b. any differences between the **smoothed contribution** and the **actuarially determined contribution** (prior to the application of any **output smoothing method**) are recognized within a reasonable period of time; and

c. the **output smoothing method** is not expected to systematically produce **smoothed contributions** less than the **actuarially determined contribution** (prior to the application of any **output smoothing method**)."

- Section 3.18: We believe that this section should be expanded to take into account the possibility that the actuary selects both a **contribution allocation procedure** and an **output smoothing method**. When selecting both, the actuary should ensure that, in the actuary's professional judgment, the combination is consistent with the plan accumulating adequate assets to make benefit payments when due, assuming that all actuarial assumptions will be realized and that the plan sponsor or other contributing entity will make **actuarially determined contributions** (after applying any **output smoothing method**) when due.

- Section 3.19: In the current ASOP No. 4, the corresponding section 3.14.2 does not include the phrase "that does not include **a prescribed assumption or method set by law**." One potential interpretation of the revised language is: if the actuary is performing a **funding valuation** for a qualified private sector plan using a **contribution allocation procedure** that produces a range of values from the ERISA minimum required contribution to the maximum tax-deductible amount, then the actuary does not need to "qualitatively assess the implications… on the plan's expected future contributions and **funded status**" because that **funding valuation** would include a **prescribed assumption or method set by law**.

  For single-employer ERISA plans, the mortality assumption, the discount rates and the unit credit actuarial cost method clearly meet the definition of **prescribed assumption or method set by law**. For multiemployer ERISA plans, the current liability assumptions that are used for a relatively minor portion of the funding determination and the set of actuarial cost methods that are permissible for this purpose could appear to also meet the definition of **prescribed assumption or method set by law**. The meaning of this Section needs to be clarified as to whether it applies even for relatively minor or limited prescriptive aspects of the assumptions or methods.

  The issue of whether or not the remainder of section 3.19 applies would also affect the disclosure requirements under sections 4.1(y) and 4.1(z).

- Section 3.20: Segal commends the ASB for proposing that the actuary should calculate and disclose a Reasonable Actuarially Determined Contribution (RADC) when performing a

funding valuation, except when it includes a **prescribed assumption or method set by law**. However, as this is the same conditional clause as in section 3.19, we see the same issues as outlined in our comments on that section.

For a plan using a prescribed basis for a **contribution allocation procedure** that wants to consider an alternative approach in between the ERISA minimum and maximum levels, it appears that (at least one of) the funding alternatives provided by the actuary would need to meet the RADC requirements. The standard should clarify that point – as applied to all types of plans.

The following paragraphs provide examples of concerns as to meeting the RADC requirements.

The single-employer ERISA minimum contribution basis does not appear to meet the RADC conditions due to the use of "stabilized" interest rates. It is unclear whether use of "*non*-stabilized" 24-month average interest rates would be considered "reasonable" as a basis for developing RADC options for an ERISA plan – we believe that should be permitted. These types of issues should be clarified.

Consider also a plan that is not subject to ERISA, but the sponsor wants to develop a contribution approach along similar lines. We believe that the actuary should be able to select the single-employer ERISA methodology (using non-stabilized bond rates, with appropriate adjustments in lieu of credit balance elections) for this plan.

- Section 3.20(b): We believe that the proposed restriction on "an **actuarial cost method** with individual attribution" should be clarified. In addition, it may be that this or other potential restrictions are not needed, especially in light of the changes we propose above to improve Section 3.14.

  Specifically, for plans that have various types of retirement benefit accruals (flat-dollar or percentage of contributions, and those that associate various percentages of salary for service rendered during certain time periods), the calculation of **normal cost** under the entry age normal **actuarial cost method** may be based on the current level of benefits that is applicable to each employee (i.e. based on that employee's current accrual rate, not that for a "replacement life"). This is commonly used and provides for a more stable contribution allocation, which is especially beneficial for plans funded by fixed contribution rates. Section 3.17(c) of the exposure draft notes that "stability or predictability of periodic costs or actuarially determined contributions" is one of the factors that should be taken into consideration. It is important to distinguish these methods from an "ultimate entry age" approach that bases the normal cost for an employee on a hypothetical replacement, potentially in a new (and far different) tier of benefits. We therefore suggest that this language could be modified as follows:

  > "if an **actuarial cost method** is used, it should be consistent with section 3.13. If an **actuarial cost method** with individual attribution is used, each participant's **normal cost**

should be based on the **plan provisions** applicable to that participant. This could be based on a member's historical accrual rate pattern or on that member's current accrual rate as if it had always been in effect."

- Section 3.20(f): We suggest that this could be shortened, as follows: "the contribution allocation procedure should be consistent with section 3.18."
- Section 4.1(y): We suggest that this should be prefaced by "if applicable," similar to 4.1(z) as section 3.19 leads to both these disclosure requirements.
- Section 4.1(aa): There is a requirement to disclose the **reasonable actuarially determined contribution** and corresponding **funded status** in accordance with section 3.20. We believe these values are also subject to the same disclosure requirements that would apply to the underlying **funding valuation.** These would include sections 4.1(k) through 4.1(t) and maybe others as well. We suggest this be clarified.
- Section 4.4: We suggest that this section be amended to be consistent with the corresponding section in ASOP Nos. 27 and 35.

Please contact us if you wish to discuss any of these views.

Sincerely,

Eli Greenblum FSA, MAAA, EA
Senior Vice President & Chief Actuary

KPERS

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.

Kansas Public Employees Retirement System Alan D. Conroy, Executive Director www.kpers.org
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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

Alan D. Conroy
Executive Director

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July 24, 2018

ASB Comments
American Academy of Actuaries
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RE: Proposed Revisions to ASOP 4

To the Members of the Actuarial Standards Board:

The Board of Trustees of the Omaha School Employees' Retirement System (Trustees or OSERS) thanks the Actuarial Standards Board for this opportunity to comment on the proposed revisions to ASOP 4. We recognize these revisions are rooted in the context of a perceived need for additional guidance for public retirement plans. As a public pension plan having served its membership for over 100 years, we have expended tremendous effort over the years working toward educating our members, the plan sponsor, the Nebraska Unicameral and the general public about appropriately funding our retirement plan. From this experience we have some observations that we believe may be of value in helping to shape ASOPs that can best advance the education of the public on pension plans.

Prescriptive or Principle-Based?
Before dealing with some specific items in the proposed revisions, we believe there are two broad issues that need to be addressed. The first of these is to note that many of the proposed changes for ASOP 4 are somewhat prescriptive, rather than being primarily principle-based. Generally, our actuaries have prided themselves in being professionals and being able to exercise appropriate judgment in applying the core principles of their profession. We have witnessed our actuaries holding steadfast to the ideal of conducting their work as professionals following these core principals.

The challenge in moving to a more prescriptive model in ASOP 4 is that there are now significantly more details that must be provided. No longer can the ASOP language call on the actuary to consider a course of action – now it must describe that course of action in a way that can fit all situations. All public pension plans are not alike. If the underlying prescriptive requirement is not based on a principle, it becomes very difficult, and perhaps impossible, to simply use professional judgment to fill in the missing steps. The point being, in order to be prescriptive and handle the wide range of real-world practice in the world of public pension plans, it may well take hundreds of pages rather than just a few paragraphs to provide adequate guidance.

Most public retirement systems currently require that an actuary they engage be a member of one of the actuarial organizations that subscribe to the Code of Professional Conduct and the Actuarial Standards of Practice, ensuring that they have someone who acts in a professional capacity. If the ASOPs for public plans become more prescriptive, at some point does the question raise whether the need and cost for professional actuaries remain necessary and will public pension plans begin to opt to engage someone who can calculate the numbers they need without including the additional ASOP-compliance information they don't need or want, reducing the influence the profession has in this area.

Limited Application

A second broad observation is that much of the new material in the proposed ASOP 4 revision may not apply to the majority of public pension plans. Section 3.20 does not apply when there is a prescribed assumption or method set by law, thereby excluding ERISA plans. Likewise, sections 3.14, 3.16, and 3.17 will not be applicable for ERISA plans because these methods are selected via federal laws and regulations. Of course, ERISA valuations performed by individuals who are only Enrolled Actuaries are already exempt from complying with any ASOPs. Another category of plans to which many of these new provisions would not seem to apply are unfunded plans. Because there is no intent to fund them formally, there would not technically be a funding valuation or the need for cost allocation procedures. Thus, many of these new sections really only apply to funded church and public plans.

At first glance, this may appear reasonable, under the presumption that if there are not already requirements for determining funding requirements, an actuary should follow reasonable procedures in setting these. Many public plans have controlling legislation that dictates much of what an actuary may do but because these rules are set by the states that established the retirement systems, the prescribed assumptions and methods exception of the ASOPs appear not apply.

Effectively, the ASOPs have set up a system whereby federally-set standards, some of which may have been legislated as a matter of delaying pension contributions to increase current tax revenues, are being presumed to be sufficient, while similar standards passed by state legislatures are deemed otherwise. It is not clear why the ASB should anticipate that officials elected to national offices will write legislation that is superior to that written by officials elected to state offices, who are more in tuned with the intricacies and nuisances of their respective plan. One size does not fit all. We recognize there are some high-profile public plans where elected officials have chosen to delay funding, perhaps even against the advice of the systems' actuaries, but we also recognize the PBGC has concerns about future finances, suggesting that the funding methods that are mandated for ERISA plans may have weaknesses as well. Excluding plans from the ASOP proposals solely because of the type of legislative body writing the rules does not appear to be exercising fiduciary responsibility.

There may be an argument that state legislators cannot objectively write funding rules for plans they establish, control, and fund. However, the plan provisions, the funding requirements, and significant information about the operations and funding progress of these systems are readily available to the public. If legislators are not behaving responsibly in the eyes of the public, the public will ultimately vote them out of office and select new legislators.

Section 3.11 - Defeasment

We next wish to address some specific issues where we believe the proposed revisions should be adjusted. First, we note that Section 3.11 requires that an actuary "calculate and disclose an obligation measure of effectively defeasing the investment risk" when performing a funding valuation. There are then some prescriptive elements of this calculation listed, including the valuing benefits accrued as of the measurement date, the cost method, and a discount rate to be selected from one of two specific sources.

Many public plans have adopted benefit provisions that mitigate the employer risk by adjusting the member benefits based on such measures as asset performance or plan funded ratio. A common example is a COLA or 13th check that is payable when the plan reaches a certain funding threshold. Another example is the use of a variable interest crediting rate tied to recent investment returns or other economic measurements. In either of these examples, the benefits are based to some degree on actual asset performance. If investment risk is eliminated by purchasing Treasuries, the expected return will be significantly lower, reducing benefits. The proposed language for the investment risk defeasement cost is not clear as to how to proceed. Should the actuary assume that the benefits will not be reduced (simply changing the discount rate in a computer program) leading to a model which has inconsistent assumptions? Or should the actuary reduce the projected benefit payments, thereby leading to a calculated risk defeasement measure that actually contains a combination of investment risk reduction and benefit cuts? This is not simply a technical issue to be addressed – there will be other variants and odd situations that will arise, requiring more and more technical modifications.

Further, the described goal of this measure is to find the cost to "effectively" defease the investment risk. However, the discount rates described in 3.11.c are related to methods that are not capable of actually defeasing the investment risk. The use of current treasury rates as the discount rate suggest an investment strategy build solely on fixed income and not the realistic inclusion of other public investment vehicles. A simple illustration should demonstrate: Suppose retirement boards had been guided to implement a strategy based upon treasury yields in 1980. Retirement board trustees would have purchased bonds that lined up with projected cash flows for the next 30 years, and then purchased some 30-year Treasuries with the coupons removed that we intended to reinvest in 2010 to cover the remaining 40-60 years of payments that would still be due. However, in 2010, interest rates were significantly lower and so retirement boards would have found they did not have enough money to make the benefit payments. The risk was not "effectively" defeased because some (substantial) risk remained. Of course, we all knew in 1980 that interest rates were high and that such levels were not likely to continue. We feel much more confident in 2018 buying bonds to defease the risk, because rates are not likely to be much lower in 2048 than they are now. But, if rates are higher in 2048 (even if still below historic averages), plans would have more money than was needed. Thus, there still remains a risk –too much money. The plan sponsor has given up some other use of that money in the meantime. It does not appear the stated goal of this section is being accomplished, but is instead suggesting plan sponsors and retirement boards demonstrate capabilities to predict interest rates well past our lifetimes.

We also note that while the goal of this disclosure calls for defeasing investment risk, one of the options (3.11.c.2) is to determine the cost of settling pension obligation, thereby eliminating all risks. While investment risk is usually the largest, there is an inconsistency between the stated intent and the method to measure it. If this method is allowed, we suggest that the actuary be further required to disclose which risks are being eliminated so that users will not be misled. Quantifying the cost of eliminating risks may indeed be valuable (and certainly is something actuaries will be considering under ASOP 51), so it is not clear why only one of those risks be identified in ASOP 4.

Section 3.11 is stated to be applicable to funding valuations. As a practical matter for public plans, of course, any study of proposed changes to benefits or funding policies are still going to require an analysis be performed on this basis as well, since the decision makers will need to know the implications of any proposed changes for the risk defeasement cost to be disclosed. It should be emphasized that this measure will be guiding decisions and will be higher profile than just a simple disclosure in a report.

While the cost to defease investment risk may be of interest to some, we anticipate that it will not be a useful measure for many public retirement systems. After all, it reflects an action that cannot be implemented by most plans. Most public plans are open to new members and many are prohibited from reducing future benefits for anyone who is currently in the plan. Attempting to defease the risk on a hypothetical benefit for a mid-career employee is purely an academic construct – and probably irresponsible at best. The accounting effort to actually carry out such a task would be incredibly challenging. Of course, as noted earlier, there are not financial instruments available that can actually defease the risk over the 80-100 years of remaining payouts expected to be made to current members. Further, these plans are investing in diverse portfolios designed to take an appropriate level of risk so as to provide benefits at a lower cost than could be managed in the absence of risk. In fact, the trustees of the plan are required by law to be prudent, and it is doubtful that a "no risk" investment portfolio would be deemed prudent.

The Nebraska Legislature has foreseen the wisdom to set prudent investment guidelines for OSERS and other Nebraska public pension plans to use as guidance. For OSERS specifically Neb. Rev. Stat. § 79-9,111 states:

> 79-9,111.
>
> Employees retirement system; investments; board of trustees; powers and duties; state investment officer; powers and duties.
>
> The board of trustees shall invest the funds of the retirement system in investments of the nature which individuals of prudence, discretion, and intelligence acquire or retain in dealing with the property of another. Such investments shall not be made for speculation but for investment, considering the probable safety of their capital as well as the probable income to be derived. The board of trustees shall not purchase investments on margin or enter into any futures contract or other contract obligation which requires the payment of margin or enter into any similar contractual arrangement which may result in losses in excess of the amount paid or deposited with respect to such investment or contract, unless such transaction constitutes a hedging transaction or is incurred for the purpose of portfolio or risk management for the funds and investments of the system. Prior to January 1, 2017, the board of trustees may write covered call options or put options. Prior to January 1, 2017, the board of trustees shall establish written guidelines for any such option, purchase, or contract obligation. Any such option, purchase, or contract obligation shall be governed by the prudent investment rule stated in this section for investment of the funds of the system. The board of trustees may lend any security if cash, United States Government obligations, or United States Government agency obligations with a market value equal to or exceeding the market value of the security lent are received as collateral. Prior to January 1, 2017, if shares of stock are purchased under this section, all proxies may be voted by the board of trustees prior to January 1, 2017. As of January 1, 2017, the funds of the retirement system shall be invested solely by the council and the state investment officer in accordance with the Nebraska State Funds Investment Act. The state investment officer may lend securities and vote proxies in accordance with the standard set forth in section 72-1246.

Thus, actuaries will be required to disclose a cost of an action that is not legal without further legislative action, not possible, nor desirable. We realize that some other disclosures may not be useful or appreciated by all plan sponsors, but such information tends to alert the plan sponsor of potential problems that they should know about. This disclosure, however, does not in most situations give the sponsor any useful information since there is no opportunity to actually defease risk. Additionally, the work required of the actuary to disclose the defeasement risk will be at a cost to the plan members, the very individuals who are the public servants contributing to these plans. Additional cost have a fiscal impact on the funding of plans. We question how such a requirement benefits anyone beyond answering some academic curiosities.

The final concern we have with Section 3.11 is that this measure may not be fully understood by those who see the number. While actuarial reports for corporate plans are presented to CFOs, human resource managers, and others in similar positions, public plan actuarial reports are placed on retirement system web sites for public download and viewing, presented to legislative committees, and written about in the media. While it is fully possible to explain to corporate senior management the nuances of unit credit versus entry age normal and funding discount rates versus risk-defeased yield curves, the general public may not be as familiar with these concepts. While the general public is not a direct intended user of these actuarial reports, those of us who serve in this area are quite cognizant that the broad public is an indirect user.

Because most public retirement systems, including OSERS, must make their valuation reports available to the public, the presence of two sets of numbers can be easily misunderstood or intentionally misused. Publicly presenting two sets of numbers will allow those with an agenda to eliminate public retirement plans to future public servants the opportunity to say that the higher number is the "true" liability. As we have heard in the past, they will be able to assert that actuaries are perhaps being dishonest in providing the calculation used for plan funding purposes. Apart from this intentional misuse, it would certainly be an easy argument that "actuaries make up all these numbers – look how different these two numbers are". These are mis-representations that have been spouted in recent years.

We strongly believe that this section 3.11 should include an "actuary shall consider" clause to provide for discretion when the issuance of additional disclosures will create confusion and/or mis-represent the consequences of an action that is prohibited at the current moment. In light of the ASOP 51 suggestion of a measure such as this as being an option, it appears section 3.11 could be eliminated altogether.

Section 3.16

The proposed language for this section should be modified to allow for a contribution rate to remain above the actuarially determined contribution for an indefinite time. The language in 3.16.a seems to prevent the smoothed rate from being too much higher, which should provide protection against unreasonable intergenerational equity issues. We do not see any reason that a smoothing method should be compelled to be lowered.

Section 3.20

This section applies for funding valuations when there is not a prescribed method or assumption set by law. In the real world, many, if not most, public plans have some additional legislative requirements for setting a method or assumption, but these requirements may not meet the definition of "prescribed assumption or method set by law" as defined in ASOP 4. Frequently, the legislative methods will nonetheless meet the requirements of this section, so that the actuary need only show one set of contribution numbers.

Our trustees understand the actuary is to disclose if a funding policy will not accumulate sufficient assets to pay the benefits of the plan. Ultimately, this is the central issue at stake. If there is a policy in place that will accumulate sufficient assets, there is little apparent value in providing an alternate measurement of a contribution rate. We believe that the requirements of 3.20 should be applicable only if the actuary has reason to believe that the current funding policy is inconsistent with accumulating sufficient assets. In that situation, the additional information serves to illustrate the needed change in contributions to fund the promised benefits, information which would be needed by the plan sponsor.

Section 3.20.g calls for the reflection of timing between the measurement date and the contribution date. For public retirement systems with multiple tiers (where successive tiers usually have lower benefits and normal cost rates) where the contribution rate is determined as of a measurement date a year or two before the implementation of the rate, this may add a great deal of complexity for very little value. The requirement, as written, does not allow for the actuary to exercise judgment regarding the significance of the factors involved. May the actuary ignore the anticipated reduction in normal cost rate of a few basis points? Must the actuary reflect that school district payroll is not exactly uniform throughout the year? May materiality be considered? In on-going plans, such differences are frequently inconsequential when compared to the probable variation in population size, payroll experience, and the like. This provision should be restated to include the phrase "The actuary should consider…" so as to avoid prescribing a high level of detail which will only serve to increase the complexity of the calculation with little impact on the result and further lend more confusion to the general public.

Concluding Thoughts
It is our understanding these proposed changes were made in response to the Pension Task Force, which in turn was formed in response to concerns about public sector pension plans. The implication seems to be that the additional requirements of these ASOPs will somehow provide actuaries with the guidance that is needed to help them act in a way that leads to changes in how public pension systems are valued, funded, designed, or presented. As we reflect over the past decade or so, there have been major shifts that have occurred with public retirement plans:

- the distribution of investment return assumption has shifted significantly lower
- the mortality assumptions of many systems has moved to a generational mortality basis
- contribution rates for employers have increased in most systems, and members have increased contributions in many cases, as well
- in Nebraska, the state also contributes to the OSERS plan and that rate has increased over the years
- benefit provisions for new hires (and for future accruals where legal) have been reduced or adjusted to share risk
- contribution determination methods have been developed to help move toward fully funding on-going plans, with some systems targeting funded ratios in excess of 100%
- the practice (inadvertently prompted by accounting standards) of an open 30-year level percentage of payroll amortization method appears to be disappearing
- the level of detail provided to board members and the general public has increased significantly

Through all of this, we see actuaries playing a significant role in helping public policy-makers make these changes. This does not suggest that actuaries are unsure of what to do and needing additional guidance, but rather that actuaries are able to work from the existing principles of the ASOPs to help advance the practice and solve problems.

What is not clear is that any of these proposed changes will cause law-makers to suddenly realize that they must make changes to public policy and choose pension funding over school funding. They may believe their role as elected officials is to serve the citizens who elected them by guiding public policy and making the challenging choices about how limited resources are to be allocated to best serve the public over time. And they may be right.

The Board of Trustees of the Omaha School Employees' Retirement System would strongly encourage more deliberation and discussion before implementing any changes.

Respectfully,

Cecelia M. Carter

Cecelia M. Carter
Executive Director

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July 30, 2018

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

RE: Proposed Revisions to ASOP 4

To the Members of the Actuarial Standards Board:

The Public Employees Retirement Board has directed me to comment on ASOP 4 on their behalf.

The Nebraska Public Employees Retirement Board (Board) and Nebraska Public Employees Retirement Systems (NPERS) are responsible for administering five different retirement plans. The Nebraska State and County plans were originally Defined Contribution (DC) plans that were converted to Cash Balance (CB) as of January 1, 2003. The Nebraska Judges, State Patrol, and School plans are Defined Benefit (DB) plans. The proposed revisions to ASOP 4 could substantially affect our CB and DB plans. Thus, we appreciate the opportunity to comment on the proposed revisions to ASOP 4.

We are opposed to the Investment Risk Defeasement Measure (IRDM) disclosure requirement. We believe the IRDM will confuse and create misconceptions amongst our plan members, policymakers, and taxpayers/public. We are also concerned that entities desiring benefit reductions or plan elimination will abuse the information required by these revisions in order to mislead those unfamiliar with the IRDM's purpose. We strive to mitigate and eliminate confusion about our plans. The IRDM disclosure requirement seem to fly in the face of that goal by forcing retirement systems to publish data that may lead to confusion and unfounded perceptions.

Under the Nebraska Constitution and Nebraska Supreme Court case law, neither the Nebraska Legislature, Board, nor NPERS can reduce future benefits for current plan members. This means there is no value in knowing the current accrued benefits in accordance with the proposed IRDM disclosure requirement.

The Nebraska Legislature created our CB plans as a benefit enhancement (from the original DC plans) following a benefit adequacy study. These plans contain risk-sharing provisions that have significantly added to the value of member benefits. If we funded these plans solely with U.S. Treasuries to eliminate investment risk, our CB plan members' accounts would be subject to slower account growth due to a loss of potential dividends. This is, functionally, a benefit reduction. Further, such a funding strategy would result in reduced monthly annuity payments for members who select this option at retirement. This would also be a benefit reduction. Clearly, trying to eliminate investment risk, and the loss of investment returns over time, is harmful to our plan members. *As statutory fiduciaries of our plan members' accounts, we must oppose such action.*

Currently, the actuarial accrued liability, total member account balances (and annuities to be paid to our retirees), and plan assets are all of similar value. Thus, our CB plans could, theoretically, terminate and fully fund all benefits. By contrast, the IRDM for our CB plans would vastly exceed the value of the CB plan member account balances and assets. This makes the CB plans appear underfunded. Such data could confuse and mislead plan members, policy-makers, and the taxpayers/public.

Due to Nebraska's Open Meetings Act and public records laws, our meetings and information are open to our plan members, policy-makers, and the taxpayers/public (subject to very narrow exceptions). We post years of history on our website, including, but not limited to, our actuarial valuation reports, actuarial experience analysis results, benefit adequacy study, GASB 68 reports, annual investment reports, and annual reports to the Nebraska Legislature. Further, news stories often appear in local periodicals regarding the systems we administer. Thus, we have taken multiple steps to ensure transparency and ensure our plan members, policy-makers, and taxpayers/public are fully aware of our plans' assets and liabilities.

If the IRDM is required, it, too, will be available to the public. If the public does not understand the purpose of the IRDM, they may come to incorrect conclusions about our plans' funded status. These conclusions could lead the public to believe the CB plans are a problem rather than a functioning solution to the benefit adequacy issues identified in the DC plans.

For the traditional DB plans, there is also distortion. While we will endeavor to explain what the numbers mean, we are concerned that some will not understand or will misuse the numbers.

Finally, we will have to pay the actuary to produce these results. This will require additional funds from the taxpayers, reducing member interest credits (and, thus, benefits), and will require us to seek additional spending authority from the Nebraska Legislature.

For the foregoing reasons, we would ask that you not adopt the proposed IRDM requirements.

Please do not hesitate to contact me if you have further questions.

Respectfully,

Randy Gerke
Executive Director
Nebraska Public Employees Retirement Systems

For the Nebraska Public Employees Retirement Board

American Enterprise Institute
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July 30, 2018

Dear Actuarial Standards Board Members:

I am grateful for the opportunity to comment on the Proposed Revision of ASOP No. 4 – Measuring Pension Obligations and Determining Pension Plan Costs or Contributions.

I am not an actuary and so on certain aspects of the Exposure Draft I lack the expertise to provide useful comments. I have, however, written extensively on public pension funding and risk-taking, including serving as co-vice chair of the Society of Actuaries Blue Ribbon Panel on Public Pension Funding. I currently have been given primary responsibility for public pensions in my role as a member of the federal government's Financial Oversight and Management Board for Puerto Rico. With that background, I hope the following comments may be helpful.

In my view, an Investment Risk Defeasement Measure (IRDM) constitutes an important addition to actuarial output that provides a more comprehensive measure of the economic costs of providing what most pensions promise: a benefit that will be paid to retirees without regard to the returns earned by the plan's investments. The present value of such a liability is most accurately measured using a discount rate matched to the risk of the benefit itself, as a risk-adjusted discount rate captures the cost of the implicit guarantee from the plan sponsor to make additional future contributions should plan returns fall below the assumed rate.[1]

My preference would be for an IRDM to be calculated as similarly as possible to the standard liability measure used by the actuary, with the exception of using a discount rate calibrated to the risk and duration of liabilities rather than the assumed return on a portfolio of risky assets. Changing only the discount rate isolates the degree to which the stated funding of the plan depends upon the realization of an investment risk premium that, by definition, cannot be counted upon with certainty.

An IRDM provides information that can be useful to pension sponsors as they make funding and investment decisions. As the Exposure Draft notes, one of the considerations facing a plan actuary is the "stability or predictability of periodic costs or actuarially determined contributions." When plan investment returns vary, this variation is carried through to volatility of required contributions from the sponsor. As I have shown in published work, required contributions can vary significantly from year to year even with the application of standard actuarial smoothing techniques.[2]

In this context, the difference between the standard liability measure and the IRDM represents the degree to which the sponsor has traded contribution volatility for a lower expected average level of contributions. Yet, as we have seen in the past decade, when a period of poor investment returns pushes required contributions too high, many sponsors cannot or will not make them in full. Even in 2017, a decade past the onset of the Great Recession, nearly one-fifth of plans listed in the Public Plans Database did not receive their full required contribution. Plan sponsors who learn that nearly half their purported funding is in fact based on assuming the receipt of an uncertain risk premium may instead choose to increase true funding and reduce excessive risk-taking. Doing so would likely lead to more stable system financing, more secure benefits for participants and less destabilization of sponsor budgets during an economic downturn.

Similarly, the Exposure Draft notes that a plan actuary must be concerned with intergenerational equity. Public plan funding adequacy measured relative to the IRDM indicates the degree to which taxpayers to date have *truly* fully funded the pension benefits accrued by the public employees who provided services to those taxpayers. The incremental plan funding measured relative to liabilities discounted at the expected return on risky assets indicates costs, in the form of investment risk, that will be borne by future generations of taxpayers who did not receive services from those groups of public employees. The application of standard options pricing techniques to pension financing shows that funding guaranteed benefits using the discount rate on risky investments unequivocally imposes net costs on future generations of taxpayers.

It is worth noting that the IRDM would provide a measure of pension liabilities at the plan level that is at least conceptually similar to aggregated measures of pension liabilities in the National Income and Product Accounts of the United States, generated by the Bureau of Economic Analysis. These IRDM-like pension liability figures also are published in the Federal Reserve's Financial Accounts of the United States. It seems appropriate that pensions report liabilities figures that are consistent with those published at the national level and, indeed, in other countries.

While the IRDM for system-wide liabilities is a very useful addition, it would also be helpful to policymakers for actuaries to publish the normal costs of plans calculated using the discount rate chosen for the IRDM. As pension costs have increased, policymakers have been forced to make decisions that reduce the value of future pension benefits. In making such decisions, and in comparing the value of pension benefits offered by a public sector plan to those offered to employees in the private sector, the normal cost calculated using a risk-appropriate discount rate provides the best measure of the value of benefits accruing to employees in coming years.[3]

On a technical level, the IRDM as described in the Exposure Draft does not work well as a sponsor liability measure for plans in which investment risk is shared with participants, although it does show the total value of risk borne by all plan stakeholders. A more sophisticated and flexible technique, such as a risk neutral stochastic simulation, could provide an IRDM-like measure for these hybrid plans.[4]

These caveats aside, the IRDM constitutes an important step in the direction of accurate and comprehensive measurement of the economic costs of the promises made by pension plans. Those costs are substantial and in some cases threaten to destabilize state or local government budgets. The Exposure Draft, if approved in similar form, would provide plan sponsors with additional useful information in making funding and investment decisions.

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Finally, I feel obliged to comment on accusations of a personal nature that the National Education Association levied in its July 26 letter to the Board regarding the Exposure Draft. The NEA cites a December 2015 *Forbes* article written by me that reported on a then-recent Congressional Budget Office analysis of Social Security replacement rates. Due to a programming error, the CBO analysis that I relied upon produced erroneous results. The CBO corrected these figures, and in a subsequent author's note to my *Forbes* article I noted that "the figures illustrated below are incorrect and should not be relied upon." Indeed, one reason the CBO realized their error was that, after failed attempt to replicate their figures, I raised the issue with CBO staff.

However, the NEA's July 26 letter accuses me of attempting to mislead the public:

> 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.

In fact, I have long argued that the SSA actuaries' calculation of Social Security replacement rates – which produce the common 40% figure – differs meaningfully from replacement rates as calculated by financial planners or by most actuaries.[5] It was due to criticisms such as my own that in 2014 the Social Security Trustees removed measures of replacement rates from their annual report. The NEA's false accusations bear no relevance to their technical comments regarding the ASB Exposure Draft. However, the NEA's personal aspersions cast doubt on the degree of good faith with which it has chosen to conduct itself in an important public policy discussion.

Sincerely yours,

Andrew G. Biggs

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[1] On pricing the implicit put option embedded in pension sponsorship see Biggs, Andrew G. "An options pricing method for calculating the market price of public sector pension liabilities." *Public Budgeting & Finance 31*, no. 3 (2011): 94-118.

[2] See Biggs, Andrew G. "The public pension quadrilemma: the intersection of investment risk and contribution risk." *The Journal of Retirement 2*, no. 1 (2014): 115-127.

[3] See Congressional Budget Office. "Comparing the Compensation of Federal and Private-Sector Employees, 2011 to 2015." April 25, 2017.

[4] Such an approach is outlined in Biggs, Andrew, Clark Burdick, and Kent Smetters. "Pricing personal account benefit guarantees: A simplified approach." In *Social Security Policy in a Changing Environment*, pp. 229-249. University of Chicago Press, 2009.

[5] While replacement rates commonly compare retirement benefits to final earnings immediately prior to retirement, the SSA instead measures benefits as a percentage of the average of the highest 35 years of pre-retirement earnings, where earnings are first adjusted upward at the rate of growth of national average wages. This approach, in particular the wage-indexed of past earnings, increases the denominator of the calculation and produces a lower average replacement rate figure. For a recent analysis see Biggs, Andrew George. "The Life Cycle Model, Replacement Rates, and Retirement Income Adequacy." *The Journal of Retirement Winter 2017*, 4 (3) 96-110.

Comment #32 – 7/30/18 – 9:13 p.m.

30 July 2018

Via email to: comments@actuary.org

Re: Exposure Draft of Actuarial Standard of Practice (ASOP) 4

Dear Members of the Actuarial Standards Board (ASB) and the Pension Committee of the ASB:

I am a life-annuity actuary who has been following issues surrounding public pensions and multiemployer pensions for some years. In addition to my interest as a taxpayer and having many friends and family who are public pension participants, my main interest is the reputation of the actuarial profession.

I have read through response letters to the draft exposure of ASOP 4 as of this date, and I generally agree with the thrust of the letters from Edward Bartholomew, Gordon Latter, David G. Pitts, and Larry Pollack, dated 23 July 2018[1]; from Robert North, dated 24 July 2018[2]; and from the Society of Actuaries, dated 19 July 2018 [3]with respect to the Investment Risk Defeasement Measure (IRDM).

I want to address three general types of objections to the IRDM.

1. **The confusion of having more than one measure for the same liability**

Actuaries in non-pension fields often must calculate liability valuations on different bases, that are used for different purposes. The most obvious example here are statutory reserves versus U.S. GAAP reserves for insurance liabilities. One measure is intended to protect policyholders by being somewhat conservative (not to mention risk-based capital requirements above that), and the other is to provide useful financial accounting for shareholders. For life insurance in specific, STAT and GAAP results can be extremely different, and actuaries have had to provide context as to why this is the case.

To quote the SOA letter of 19 July: [emphasis added]

> "The Investment Risk Defeasement Measure provides important information to assess the degree of risk in a plan's funding and investment policy that, **when accompanied by an actuarial report that provides context for its meaning**, improves pension plan sustainability."

Actuaries can explain that the IRDM was intended to provide a "risk-free" valuation of already accrued pension benefits, to separate what is supposed to be un-risky promises from sometimes very risky assets. I am sure there can be some sort of standard language to give an explanation that may be less contentious than, say, "the taxpayer/bondholder/participant put value" as the difference between the IRDM and the pension value reported for accounting purposes.

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[1] http://www.actuarialstandardsboard.org/wp-content/uploads/2018/07/Comment-11.pdf
[2] http://www.actuarialstandardsboard.org/wp-content/uploads/2018/07/Comment-14.pdf
[3] http://www.actuarialstandardsboard.org/wp-content/uploads/2018/07/Comment-8.pdf

2. How to deal with non-guaranteed benefits

This is in context of trying to calculate the IRDM, when there are risk-sharing elements of the pension benefits or other non-guaranteed elements. There are similar challenges in valuation of life-annuity products, which often have non-guaranteed elements with risk-sharing characteristics.

I agree some sort of guidance would need to be given as to how these elements are handled in an IRDM calculation, similar to ASOPs covering nonguaranteed elements of life/annuity contracts (ASOP 52, Principle-Based Reserves for Life Products under the NAIC Valuation Manual, seems the most relevant for a starting point on guidance.)

3. The issue of providing information/communication to non-principal stakeholders

Again, this situation is not unique to pension actuaries. Actuaries working for insurers as their principals often find other audiences for their work: policyholders, regulators, and credit rating agencies, for instance. Government actuaries may have their governmental employers as principals, but the public obviously has an interest in their work as well.

There are obviously very interested parties outside the plan sponsor or the pension fund trustees: plan participants, bondholders of the sponsor, and taxpayers who are asked to provide the backstop for these plans (whether public or private pensions).

This is where my interest of the reputation of the actuarial profession comes in.

We are expected to be the disinterested quantifiers of contingent liabilities. Our profession has had a reputation of high integrity such that our reports and calculations could be relied on. While this does not occur frequently, actuaries have refused to sign off on what they considered insufficient reserves, sometimes resigning their positions. The former chief actuary of Medicare, Richard Foster, considered resigning when his "principal" (a.k.a. the Executive branch of the U.S. government) tried to block him from communicating his analysis of proposed changes to Medicare to the Legislative branch. As Barbara Lautzenheiser, then-President of the American Academy of Actuaries wrote about Foster in April 2004:[4]

> "We support the principle that sound, unbiased actuarial analysis should be available to decision-makers, in both the public and private sectors. The open exchange of information is crucial to our democracy. The news reports have brought to the public's attention the value of actuarial analysis and the role of the actuary in determining national policy."

While actuarial organizations such as the Academy provide independent information for public policy-makers, given the multiplicity of pension plans in the U.S., the actuaries working directly on them are in the best position to show the specific risks being taken in those specific plans. The "principal" may not be interested in that risk being exposed, no more than did some insurers wishing too low reserves or a presidential administration that wanted to low-ball prospective policy costs.

In this, I agree with Robert North's letter of 24 July[5]:

> "As noted, actuaries are often not the decision makers on the actuarial assumptions and methods employed to determine financial commitments to many Public and Multiemployer

[4] https://www.actuary.org/files/publications/Actuarial_Update_April_2004.pdf
[5] http://www.actuarialstandardsboard.org/wp-content/uploads/2018/07/Comment-14.pdf

> Pension Plans. In these cases, actuaries may, nevertheless, be perceived by the public as responsible (i.e. the actuaries are the experts) and subject to ridicule if they try to hide behind the "it was not my decision" defense when things go wrong. This suggests that having strong actuarial standards is important to protect, not just the actuaries, but Plan participants, the public and everyone else involved with Pension Plan financing."

I also agree with the SOA when it writes in its comment letter of 19 July[6]:

> "The SOA Board recommends this measure [IRDM] not be removed or meaningfully changed as ASOP 4 is revised, including any changes that would allow an actuary or plan sponsor to opt out of its calculation."

If the ASB does not include a measure substantially similar to the IRDM, the likelihood is that other, non-actuarial, parties will continue to encroach upon actuarial analysis in the sphere of pensions, and that the actuarial profession will lose credibility in being able to contribute to policy development in this area.

Thank you for this opportunity to comment,

Mary Pat Campbell, FSA, MAAA

[6] http://www.actuarialstandardsboard.org/wp-content/uploads/2018/07/Comment-8.pdf

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Donald E. Fuerst

July 31, 2018

Actuarial Standards Board
1850 M Street NW, Suite 300
Washington, DC 20036-4601

Re: ASOP No. 4 Exposure Draft

Dear Members of the Actuarial Standards Board:

Thank you for the opportunity to provide comments regarding the ASOP No. 4 exposure draft. I am pleased to provide the following comments which reflect solely my own opinion.

I commend the ASB for a generally excellent exposure draft. I hope my comments may assist you in making some modest improvement.

Discount Rate for IRDM

The ASOPs have a history of being principles based and not prescriptive. I support the principles-based ASOPs and suggest that essentially the same result can be obtained by specifying the objective of a discount rate that represents minimal default risk. The two rates currently cited in the exposure draft could be mentioned as meeting that criteria and could be safe harbor selections for the actuary. This change might allow the actuary to use a similar rate and a calculation that is currently disclosed, e.g. current liability, if the actuary determines the difference is not material.

Actuarial Cost Method for IRDM

In my opinion, the IRDM's greatest value is obtained by comparing it to a similar measure determined using the expected rate of return on plan assets (EROA). This comparison determines the amount of gain the plan sponsor expects to attain by taking on investment risk. Unfortunately, a similar measure using the EROA may not be available unless the funding valuation uses the unit credit cost allocation method. This could be rectified by either:

1. Requiring the benefit obligation represented by the IRDM to be determined a second time using the EROA, or
2. Requiring the benefit obligation represented by the IRDM to be determined using the cost allocation method used in the funding valuation.

Method 1 has the advantage of also providing an estimate of the amount needed to settle the current obligations of the plan. Method 2 has the advantage of better representing the investment gain the sponsor expects to earn under the funding method actually utilized by the plan. I suggest either method provides useful information and under principles based ASOPs, the actuary should be able to choose the method that he/she thinks is most useful.

July 31, 2018
Actuarial Standards Board
Re: ASOP No. 4 Exposure Draft

Amortization Method

Amortization payments are a component of the cost allocation or contribution allocation applicable to a specific time period. If the result of this allocation is an unfunded accrued actuarial liability (UAAL) that is expected to increase during the time period, the allocation is insufficient to be considered a reasonable actuarial method. Likewise, if the allocation is insufficient to fully amortize the UAAL in a reasonable period of time, the method is not reasonable. In other words, negative amortization in any year is not reasonable and any reasonable method must fully fund the UAAL in a reasonable period of time.

Section 3.14 of the exposure draft does not meet this criteria. It would deem reasonable a method that allocates nominal interest on the unfunded accrued liability plus $1 but such a method would not fully fund the UAAL in a reasonable time period. Section 3.14 (b)(i) would allow the UAAL to increase. Methods that allocate insufficient amounts to the applicable time period should not be considered reasonable.

This could be corrected simply by changing the “or” in Section 3.14 to “and”, and by deleting 3.14(b)(i).

Sincerely,

Donald E. Fuerst, FSA, FCA, MAAA, EA

Comment #34 – 7/31-18 – 8:19 a.m.

I am Leon F. Joyner, Jr., FCA, ASA, MAAA and EA. I have worked with many types of retirement plans in my career. Since 1990, I have been predominately working with public sector retirement systems. I thank the ASB for this opportunity to comment on the exposure draft of a proposed revision of ASOP No. 4, *Measuring Pension Obligations and Determining Pension Plan Costs or Contributions*. In general, I agree with many of the proposed revisions. The ASB has received many well-written responses. Therefore, my comments will focus on two major areas of concern for me and some of the clients I represent.

My comments include responses to the two questions asked in the cover memo as well as further details on my two major areas of concern.

Responses to Questions

The following are my responses to the questions asked by the ASB:

1. Section 3.11, Investment Risk Defeasement Measure, requires the calculation and disclosure of an investment risk defeasement measure when the actuary is performing a funding valuation. The guidance allows for discount rates to be based upon either U.S. Treasury yields or yields of fixed income debt securities that receive one of the two highest ratings given by a recognized ratings agency. Are these discount rate choices appropriate? If not, what rate choice would you suggest?

   Since this is a risk measurement, standards for determining this measure should be included in the risk ASOP not the funding ASOP. If the ASB insists on this measure in the funding ASOP, I believe that the standard should be less prescriptive, so that additional choices are available including the option to not determine this liability in situations where defeasement is not a realistic option either by statute or by practicality.

2. Under certain circumstances, section 3.20, Reasonable Actuarially Determined Contribution, requires the actuary to calculate and disclose a reasonable actuarially determined contribution. Do the conditions in this section describe an appropriate contribution allocation procedure for this purpose? If not, what changes would you suggest?

   I support the requirement for this calculation and disclosure. However, I believe that certain restrictions on the actuarial cost method (i.e. the banning of "ultimate EAN") are not needed in light of the other restrictions on the contribution allocation procedure specifically on amortization methods in section 3.14. However, if the restrictions on actuarial cost methods (particularly the banning of ultimate entry age) are included in the final ASOP, then a transition period should be provided to allow plans that currently use a future banned method to come into compliance without significant disruption in their budgeting process.

Comments on Major Issues with the Exposure Draft of the Proposed Revision

Investment Risk Defeasement Measure

- I suggest that investment risk defeasement measure be defined in section 2. Since it is unclear to me the ASB's intent for this measurement, I leave the drafting of a definition to the ASB to add clarity. Regardless of the definition, Section 3.11's first sentence should be modified as follows, "If the actuary is performing a funding valuation, the actuary should calculate and disclose an investment risk defeasement measure unless such measure is inconsistent with statutory obligations or practical realities and therefore prone to misunderstanding and potential abuse..."

- Section 3.11: In addition to the comment above (the proposed addition of a definition of investment risk defeasement measure), I believe that this section should be less prescriptive and take into account the possibility of using other approaches that in the actuary's professional judgment are consistent with the purpose of this measurement including not providing this determination in situations that make no sense either statutorily or practically. This revision could potentially reduce both the amount of additional work required and the possibility of confusion for the user. One approach to implementing this suggestion would be to revise the end of (c) along the following lines.

  "Examples of discount rates that the actuary could use include:

    1. U.S. Treasury yields;
    2. Current liability discount rates;
    3. rates at which the pension obligation can be effectively settled (either statutorily or practically);
    4. rates published by the PBGC for plan terminations;
    5. rates implicit in an annuity purchase quote from an insurance company; or
    6. In situations where liabilities have a direct relationship to a market index that is not described above, the discount rate should reflect that relationship."

- Section 3.11: Plans may not be able to defease investment risk due to statutory requirements to maintain the plan on an ongoing basis, as well as statutory restrictions on investments. The standard should provide context (or the option to not perform the calculation) for calculating the investment risk defeasement measure when investment risk cannot be defeased. I also think we should require stronger language about the appropriateness and correct use of such a measure. Since the statement itself indicates that this measure may not have a place in the real world why do we believe it is appropriate to charge our clients for a number other parties may want for their own purposes. The inclusion of this measurement (as a requirement when doing a funding valuation) will lead to confusion and uncertainty as to what actuaries are actually trying to report on behalf of our clients. If this calculation is to be required, it should be under ASOP 51 not ASOP 4.

Banning Ultimate Entry Age Normal

- Section 3.20(b): I do not believe that the restrictions on the actuarial cost method are necessary or appropriate. The banning of "ultimate EAN" will create disruption for many entities. The ban also removes an option for plan sponsors to use in correcting deficiencies in plan design that were enacted many years ago and which they are statutorily stuck. Please note the following discussion and description of the use of "ultimate EAN":

- An essential part of the public sector budgeting process is that large budget items, including pensions, should have a level cost pattern from year to year to the extent possible. Many actuaries and entities have recognized the importance of this requirement and structured a methodology for allocating pension contributions to time periods so that, if the actuarial assumptions are exactly realized, the required contributions will remain level as a percent of pay from year to year.

  Fundamentally, the required contribution has two components:

  Normal Cost – The allocation to the coming year of pension costs for active employees in that year.

  Amortization of the Unfunded Actuarial Accrued Liability (UAAL) – The coming year's payment toward pension costs allocated to prior years for which assets are not yet on hand.

  The Entry Age Normal (EAN) actuarial cost method determines the Normal Cost for an individual by calculating the level percent of pay that, if contributed each year over that person's career, would accumulate with interest to the amount projected to be needed to pay that person's pension benefits, and multiplying that "Normal Cost rate" times the person's current pay. Clearly, that produces the desired outcome with respect to each individual – a level percent of pay Normal Cost from year to year. Where there is a single plan of benefits applicable to all service for all employees, the total Normal Cost – the summation of the individual Normal Costs – will also remain essentially level for the group, if the distribution of hire ages and retirement ages is stable. Further, each time there is a termination of employment (due to retirement, death, disability, or other termination), there will be no change in the total Normal Cost rate if the replacement employee is hired at the same age as the age at hire of the terminating employee.

  A complication arises if the plan of benefits is not the same for all service for all employees. In that circumstance, the Normal Cost rate will change if the terminating employee is in Plan A and the new hire is in Plan B. If Plan A is more generous, then there will be a tendency for the Normal Cost rate to decline as a percent of pay over time, as Plan A employees terminate and are replaced by Plan B employees. This no longer meets the level funding objective.

  This problem is addressed by determining the Normal Cost as though Plan B, the plan applicable to new hires (so-called "replacement lives"), covered everyone. In the case where Plan B is less generous, that produces a lower Normal Cost than reflecting each person's actual plan. With that variation on EAN, there is once again a level Normal Cost.

  Of course, an essential requirement of any typical actuarial cost method is that the present value of all future benefits for existing participants must be matched by the value of assets on hand plus the present value of future required contributions. The reduction in the current and future Normal Cost for Plan A people who are assigned a Plan B Normal Cost must therefore be offset by an increase in the UAAL that has the same present value. For a plan where the UAAL is routinely amortized as a level percent of pay, the end result is exactly what is desired. Each of the two components of the required contribution is a level percent of pay, so the total is as well. Whether the required contribution for the coming year is higher or lower as a result depends on a number of additional factors. Eventually, however, all benefits need to be funded, so this is a timing effect only.

If the ASB proceeds with its plan to ban "ultimate EAN" then the ASB should include a transition period such that, the actuary may transition to an acceptable method over a period up to 10 years to prevent disruption in setting contribution rates provided that such a transition period does not conflict with making required benefit payments.

Thank you for your consideration of these comments.

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Comments on the Exposure Draft of the

Proposed Actuarial Standard of Practice No. 4: Modeling Pension Obligations and Determining Pension Plan Costs or Contributions

July 31, 2018

The Actuarial Standards Board

The American Retirement Association (ARA) and the ASPPA College of Pension Actuaries (ACOPA) appreciates this opportunity to comment on the exposure draft of the Actuarial Standard of Practice (ASOP) on *Modeling Pension Obligations and Determining Pension Plan Costs or Contributions*.

ARA is a national organization of more than 24,000 retirement plan professionals who provide consulting and administrative services for qualified retirement plans covering millions of American workers. ARA members are retirement professionals of all disciplines, including consultants, investment professionals, administrators, actuaries, accountants and attorneys. All credentialed actuarial members of ARA are members of ACOPA, which has primary responsibility for the content of comment letters that involve actuarial issues. The following are ACOPA's comments on the proposed actuarial standard of practice:

1. Section 4.4 Confidential Information is titled the same in proposed ASOP's 4, 27 and 35 but changes were added only in ASOP's 27 and 35. We think the intention was to have the same language in all three ASOP's. In ASOP 4, however, the section reads:

   "<u>Confidential Information</u>—Nothing in this standard is intended to require the actuary to disclose confidential information."

   ACOPA recommends consistent language in all three ASOP's, such as in ASOP's 27 and 35, which reads:

   "<u>Confidential Information</u>—Nothing in this standard is intended to require the actuary to disclose confidential information (as defined in the *Code of Professional Conduct* [Code]). Any confidential information shall be handled in a manner consistent with Precept 9 of the Code."

2. In the Background, the prior language in the first sentence of the Background stated the ASB provides "coordinated guidance". The word "coordinated" was removed in the Exposure Draft. ***ACOPA recommends*** the ASB should continue to refer to "coordinated guidance", as this better reflects the intention of the ASB to avoid conflicts between the ASOP's as well as to provide guidance on specific ASOP's.

3. Section 3.11 requires a quantitative disclosure of an investment risk defeasement measure. The concept of an investment risk defeasement measure is not defined so the actuary can neither calculate the measure nor provide meaningful commentary on its significance.

   A more meaningful disclosure to plan sponsors would be a termination liability measure. ***ACOPA recommends*** that rather than require an additional calculation, either the ERISA section 4044 or PBGC liability calculations, in the actuary's professional judgement, should be sufficient a means of disclosure.

   In the event that section 3.11 is finalized to nevertheless require a quantitative disclosure of an investment risk defeasement measure, ACOPA believes it would be helpful to include an appropriateness or materiality threshold for providing a defeasement measure. Considerations could include thresholds related to the size of the plan (either number of participants or asset level), whether the plan is in its first year or is in its early years, the time horizon remaining in the plan, and the investment mix of the plan. With respect to discount rates, considerations for different options could include whether it is more appropriate for smaller plans to use section 417(e) interest rates, market annuitization interest rates, or liability driven interest rates.

4. Section 3.21 has an example that infers a very limited scope where a gain loss analysis may not provide decision-useful information. ***ACOPA recommends*** instead a more meaningful example of a "limited group of individuals" that accounts for most of the actuarial accrued liability, rather than a "single individual".

5. Section 4.1 bb includes the phrases "if applicable" and "may meet" which implies that no disclosure is required if in the actuary's judgment a gain loss analysis would not provide decision-useful information. ***ACOPA recommends*** that the disclosure requirement be clarified or made explicit.

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This letter was prepared by the ASOP Task Force of the ACOPA Professionalism Committee, Lynn Young, Chair. If you have any questions, please contact Martin Pippins, Executive Director of ACOPA, at (703) 516-9300 ext. 146.

Thank you for your consideration of these comments.

Sincerely,

/s/
Lynn Young, MSPA,
Chair ASOP Task Force

/s/
Martin L. Pippins, MSPA,
Executive Director
ASPPA College of Pension Actuaries

/s/
Bill Karbon, MSPA, President
ASPPA College of Pension Actuaries

/s/
John Markley, MSPA, President-Elect
ASPPA College of Pension Actuaries

GOVERNMENT FINANCE OFFICERS ASSOCIATION OF TEXAS

July 31, 2018

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

Via email to comments@actuary.org

The Board of Directors of the Government Finance Officers Association of Texas ("GFOAT") would like to take this opportunity to respond to the Actuarial Standard Board's Exposure Draft on "*Measuring Pension Obligations and Determining Pension Plan Costs or Contributions*." The GFOAT is an affiliate the Texas Municipal League, which represents over 1,100 Texas cities and towns. The GFOAT's over 1,000 members represent all levels of state and local government in Texas. Additionally, GFOAT membership represents associates from the audit profession, the investment community, the underwriting community, and a variety of other private-sector finance professionals.

GFOAT has not historically provided comments to the Actuarial Standards Board ("ASB"), but believes that this is the right time to provide feedback to the proposed Standard of Practice, as well as request relief on a topic that has not previously been addressed by the ASB.

Most Government Employer Plan Sponsors are "Other Users" Under Actuarial Standards of Practice

The actuarial literature defines "Intended User" "*as any person that the actuary identifies as able to rely on the actuarial findings"* and "Other User" "*as any recipient of an actuarial communication who is not an intended user"*. Given that in government, the independently governed pension plan hires the actuary, they in essence are able to choose whether they want their employer sponsor to be an "intended user". With the issuance of GASB 67 & 68 by the Governmental Accounting Standards Board, separate reporting valuations have become common place along with a much greater emphasis on the employer's responsibility for pension related financial reporting. In many cases, the pension plan has been willing to have the actuary address the reporting valuation directly to the employer making that employer an intended user and providing the employer a basis of reliance on the actuarial findings. In other instances however, the plan and their actuary refuse to acknowledge the employer's legitimate need for the reporting valuation information. In addition to not naming the employer as an intended user some plans and their consulting actuaries have even placed additional scope, distribution and liability restrictions on the report making it clear that the actuary works for the pension plan only and has no obligation to any third party including the employer that funds the plan. This places these employers and particularly smaller, less sophisticated government employers in an extremely awkward and untenable position. All census data and historic information is maintained at the plan level, the valuation is already performed by the plan actuary and yet they are expected to incur the additional cost of hiring their own actuary simply to be able to rely on the valuation.

GFOAT obviously believes that employer sponsors should be an intended user for both funding and reporting valuations but view the ASB's total lack of guidance regarding reporting valuations as especially egregious. **Government employer sponsors have reporting obligations to their taxpayers, creditors and the general public that the actuarial profession should acknowledge and support.** Specifically GFOAT recommends that:

- **Reporting valuations should be defined as valuations whose contents and methods are prescribed by a nationally recognized accounting standards standard setter or a Federal agency with responsibility for overseeing or insuring the pension benefits.**
- **The intended user of a reporting valuation should be specified as either the employer sponsor who is placing the results of the valuation in their external financial statements, the regulating federal agency or the general public.**
- **The scope of ASOP 51 regarding risk disclosures should be amended to include reporting valuations as investors and creditors are already calling for employer sponsors to include ASOP 51 disclosures in offering statements when they issue debt. These creditors are entitled to information of this kind in order to make informed financial decisions and do not understand the position this places on the "other user" employer as there are no ASOP 51 risk disclosures for reporting valuations and they are not in a position to judge whether the required funding valuation disclosures would apply equally to a reporting valuation. Additionally, employers, their auditor and their governing board need to fully understand the pension numbers they are placing in their financial statements in order to fulfill their responsibility for the fair statement of the financial statements.**

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ASOP No, 4, Section 3.11 – Investment Risk Defeasement Measure

GFOAT expresses strong concern about the proposed guidance for Section 3.11 – Investment Risk Defeasement Measure. As proposed, the actuary who is performing a funding valuation should calculate and disclose an obligation measure to reflect the cost of effectively defeasing the accrued actuarial liabilities of the plan.

Investopedia defines the term defeasance as "a provision that voids a bond or a loan when the borrower sets aside cash or bonds sufficient enough to service the borrower's debt." This is a commonly understood term in finance, and conveys the meaning that the borrower has taken the necessary steps to extinguish any additional liability for the obligation. GFOAT believes that the term defeasance will mislead the users of funding valuations by leading them to believe that there is a pension contribution that can be made to eliminate future obligations relating to their pension. This is certainly not the case for active plans, since the obligation only includes benefits accrued as of the measurement date, and future obligations will have already accrued by the time the valuation is completed and many of the future payments will occur past the period for which high qualit6y federal securities are available (typically 30 years) .

GFOAT notes that even for a closed plan, a defeasement measure will not serve the purpose of actually defeasing the liability, since assumption experience will change the amount needed for defeasance until the liability is fully satisfied. As such, GFOAT believes that a "defeasement measure" will simply add to the confusion and not alleviate it. We understand the importance of the discount rate and believe that the Governmental Accounting Standards Board (GASB) developed an acceptable alternative when requiring sensitivity analysis of the discount rate being 1% higher or 1% lower and recommend that such requirement be included in the ASOPs for both funding and pricing valuations.

Other Miscellaneous Provisions. GFOAT has noted and is in general support for the following proposed changes but is suggesting certain enhancements to the proposed items:

Section 3.8-Actuarial Assumption. This a positive change as it reemphasizes the concept of no significant bias and closes the loop on the cumulative effect of immaterial assumptions.

Section 3.14-Amortization Methods. While this is a positive change, it still allows too much room for "creative" amortization. We have seen pension plans that have used open amortization, level percent of payroll and unrealistic covered payroll assumptions to keep contributions as low as possible never disclosing that these artificially low contributions don't come close to covering the growth in the liability due to the nominal interest. It should be no surprise that these same plans saw their funded status deteriorate quickly. We would suggest:

a. The phrase "exceed nominal interest" be better defined to prohibit an excess of $1 for a multi-million dollar liability.
b. If the calculated payment does not exceed nominal interest, this fact should be clearly disclosed in the actuarial communication. One option would be to require the dual term accretion/amortization to be used to indicate that the method begins by growing the liability and only later actually amortizes it.
c. We would prefer an "**and"** rather than an "**or"** in the phrase: *"…method that produces amortization payments that exceed nominal interest on the unfunded actuarial accrued liability or that satisfy the following conditions…:*" The reality is that as written an actuary could choose an excess of $1 and in substance turn the payment into a perpetual interest only payment not amortizing anything but still calling it amortization.

Section 3.21 Gain and Loss Analysis. We also support this proposal but given the long-term nature of pensions we would add that the actuary should disclose any assumption that has produced all gains or all losses for three or more years in a row as this could provide insight as to whether the assumption truly has no significant bias.

Section 4.1 Communication Requirements. While these changes appear reasonable (except as already noted in this letter) as an "other user" we have noted that ASOP 41-Actuarial Communications states *"An actuarial report may comprise one or several documents"* and goes on to state; *"Where an actuarial report for a specific intended user comprises multiple documents, the actuary should communicate which documents comprise the report*." As there is no specificity on how the actuary must communicate the existence of multiple documents we have seen actuarial certification letters that have excluded key required disclosures on assumption methods etc. with no reference to their existence in other documents. This can be confusing or even misleading to "other user" employers and their auditors who may not be aware of the existence of the other documents. Accordingly we recommend that a comprehensive listing of the existence of all documents comprising the actuarial report be required to be part of each document.

In summary, we believe that the actuarial profession and related actuarial information on pensions is simply too vital to the public interest for ASOPs to not specifically acknowledge and provide guidance regarding financial reporting valuations and the actuary's duty to the sponsoring employer and the general public. GFOAT thanks you for the opportunity to provide feedback and the undersigned are available to provide clarification to these comments as needed.

Respectfully:
(submitted via email)

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July 31, 2018

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

Re: 2018 Proposed Revision of Actuarial Standard of Practice (ASOP) No. 4

The Government Finance Officers Association (GFOA) appreciates the opportunity to provide comments to the Actuarial Standards Board (ASB) on the proposed changes to Actuarial Standard of Practice (ASOP) No. 4 regarding measuring pension obligations. We submit these comments on behalf of the more than 20,000 state and local government members across the country, many of whom sponsor or participate in public pension systems. In particular, GFOA's Committee on Retirement and Benefits Administration (CORBA) is familiar with the ASB's work because CORBA is responsible for tracking new industry practices, regulatory and legislative developments, as well as issuing best practices and advisories to assist public pension and personnel officers.

We do not intend our comments to respond to all areas of the proposed standard. Our comments are primarily focused on the proposed requirement to publish the Investment Risk Defeasement Measure (IRDM). We feel the requirement to publish this number is inappropriate and we have opposed previous (as well as current efforts) to require a very similar number through federal legislation. Further, we feel the ASB has already established more appropriate risk assessments that were promulgated in ASOP No. 51. Therefore, we urge the ASB to not move forward with requiring disclosure of the IRDM.

IRDM is PEPTA Measure

GFOA recognizes the IRDM described in the proposed revision to ASOP No. 4 as very similar or identical to the reporting required under the Public Employee Pension Transparency Act (PEPTA), which was first introduced in the U.S. House of Representatives in 2010 and has since been reintroduced in subsequent sessions of Congress, including the current one. GFOA, along with other organizations representing public pension systems, has opposed this legislation since it was first introduced.

GFOA understands the proposed IRDM and the required reporting in PEPTA to be what is commonly referred to as a settlement value, or the cost to settle or annuitize benefit payments accrued to date using low risk fixed-income investments. Accordingly, GFOA's principal objection to the IRDM is the same as its objection to PEPTA, namely, that settlement values are neither appropriate nor useful for many state and local public pension plans.

The Great Recession presented significant challenges across many sectors. State and local governments, in particular, were especially challenged by limits on revenue sources available for providing public services. All 50 states and numerous localities reacted to the financial crisis in different ways that fit the unique budgetary, legal, and political constraints of each entity. Nearly all have taken steps to strengthen their pension funding in the years since the financial crisis, and many have modified pension financing, benefit structures, or both.

These difficult choices, albeit sometimes controversial, were necessary because most public pension plans are legally bound to pay promised benefits. Very few plans are able to terminate or settle liabilities, most employers cannot disaffiliate with plans, and in some cases, even future benefit accruals are guaranteed. This makes the market sensitive, point-in-time IRDM measure irrelevant to the vast majority of public plans and plan sponsors that cannot settle their pension obligations. This number may be more appropriate in the corporate setting, but state and local governments cannot shut their doors when faced with fiscal hardship.

Furthermore, the IRDM would be an additional "official" plan number, adding to the funding disclosures, accounting disclosures, and rating agency determinations used to inform plan stakeholders. Not only does this result in extra costs, but the multiplicity of measurements introduces financial confusion that can be used as justification for modifying or rejecting significant corrections in the funding or amount of plan benefits.

The confusion would stem from the fact that state and local governments must already contend with several separate pension numbers calculated for different purposes. One number currently calculated represents the Net Pension Liability that is placed on basic governmental financial statements and is the result of a recent change implemented by the Governmental Accounting Standards Board (GASB). Another number calculated is one for a state or local government's budget that determines their annual pension contribution to ensure proper funding of benefits. And yet one more number is essentially pension data adjusted at the discretion of rating agencies to be used to inform bond ratings. It seems adding another number would certainly create additional confusion among potential users of the information.

Beyond the risk of confusion, GFOA's concern over the potential misuse of the IRDM also stems from how the number is derived and how it is commonly represented. Proponents of disclosing IRDM-type measures (as in PEPTA) argue that this number is a more accurate representation of a plan's status. GFOA emphatically disagrees with that claim. Public pension plans work with independent actuaries to determine a discount rate based on an assumed rate of investment return to project how much they expect their investments to earn in the years to come, as an offset to the need for future contributions. Thus the funding calculations correctly reflect the expected contributions required to fund the promised benefits.

On the contrary, the IRDM would present a theoretical liability for settling accrued benefits. The measure would be volatile from year-to-year, not based on progress made towards funding the promised benefits, but based on variations in the theoretical economic value of the benefits calculated using volatile bond market yields. Further, the record clearly shows that critics of state and local pensions would focus upon this data and use it to ignore or even challenge the validity of the more appropriate funding information already available.

ASOP No. 51 Already in Place

One of the foremost challenges for those who govern or manage public pension funds is to understand in a comprehensive manner the variety of risks facing a pension fund. Thus GFOA's CORBA Committee strives to keep track of the latest developments in industry practices like methods to assess risk. Through that effort members were aware of the ASB's work as it relates to risk, in particular, ASOP No. 51 – *Assessment and Disclosure of Risk Associated with Measuring Pension Obligations and Determining Pension Plan Contributions.* ASOP No. 51 was even discussed during a pension de-risking session at GFOA's recent annual conference.

ASOP No. 51 was intended to help plan sponsors better understand the risks associated with funding their pension plans. What is notable to GFOA is that given the IRDM is purportedly about assessing risk, it was not included in ASOP No. 51 even though that is where, as a risk measure, it should have been considered.

ASOP No. 51 Provides Appropriate Risk Measures

ASOP No. 51 includes significant guidance on assessing and disclosing risk, was recently adopted by the ASB and will become effective later this year. We believe ASOP No. 51 provides a much more thorough and consistent framework for considering and communicating risk than does the IRDM.

The ASB should allow time for ASOP No. 51 to go into effect and do the work it is intended to do rather than move forward with the IRDM disclosure requirement in the proposed revision of ASOP No. 4. Requiring this additional measurement that purportedly assesses risk but is outside of the standard that was primarily focused on risk assessment makes the actuarial standards for pension valuations appear inconsistent and unstable.

Conclusion

For the reasons discussed, we strongly request the ASB remove the IRDM from further consideration. It is not a meaningful or useful measurement for state and local pension plans, it is likely to lead to confusion or to be misrepresented, and it is out of place given the framework to assess and communicate risk already provided in ASOP No. 51. We appreciate this opportunity to provide feedback on behalf of the Government Finance Officers Association.

Please feel free to contact me at mbelarmino@gfoa.org or (202) 393-8024 if you have any questions on or would like to discuss any of the information provided in our comments.

Sincerely,

Michael Belarmino
Senior Policy Advisor, Federal Liaison Center

Comment #38 – 7/31/18 – 11:08 a.m.

July 31, 2018

Dear Members of the Actuarial Standards Board,

I was a member of the SOA's Blue Ribbon Panel on Public Pensions (BRP). Your proposed changes represent a healthy strengthening of standards. Also:

- Amortization periods should not extend beyond the average expected future working lives of employees so that plans are fully funded upon retirement.

- Actuaries should be required to provide the basis for their determination that assumptions are reasonable.

- The IRDM should also be applied to the calculation of contributions so that readers may assess the risk associated with the funding program.

David Crane

Lecturer, Stanford University

President, Govern For California

415-672-4402

Comment #39 – 7/31/18 – 11:15 a.m.

To the Actuarial Standards Board—I would like to offer a few thoughts with respect to ASOP's 4, 27 and 35 that are currently in exposure draft.

Let me begin with a bit of personal background. I am currently a retired actuary but was previously the Chairman, CEO and President of Principal Financial Group. I was fortunate to be the Academy President in 1995/1996 and have been involved in Academy work for more than 30 years. In the early part of my career, I was more involved in the pension industry but migrated to a more executive career for the past 20 years. I do NOT consider myself a subject matter expert with respect to choosing actuarial or economic assumptions. However, I was fortunate to be part of the Society of Actuaries Blue Ribbon Task Force on Public Pension Plans that was chaired by Bob Stein, FSA. That work is the primary basis of the comments that I offer today.

My comments are not specific to any of the ASOP's but are more general in nature. As we performed our research for the Blue Ribbon Task Force and started to formulate our recommendations, it was very clear to me that in broad and general terms, public plan actuaries needed to be much better at working with Trustees and plan sponsors at understanding how pension plan costs vary under a SERIES of actuarial and economic assumptions. Too often, public plan actuaries presented costs under a single set of actuarial and economic assumptions thereby not helping Trustees and plan sponsors to know how costs might change under conditions of high inflation, low inflation, high interest rates, etc. Said in a more general way, public plan actuaries were not (in my view) carrying out their important responsibilities to not only create the proper costs for the current plan year, but to educate plan sponsors and beneficiaries of how costs and funding levels vary across a range of actuarial and economic assumptions.

As I said, these comments are not with respect to any one of these ASOP's but I would hope that there might be a preamble or some other way of embedding this thought into each of the ASOP's overall. It is only by doing a better job of educating plan trustees, plan sponsors and beneficiaries that we can hope to help the general public understand the challenges of public plans and what solutions might exist to help align benefits and revenue.

I hope these comments will be of value to the ASB. I am deeply appreciative of the work that the ASB members to do help the actuarial profession carry out it's important responsibilities to the public. If there are any follow-up questions, please feel free to contact me at: Zimpleman.Larry@gmail.com.

Regards,

Larry Zimpleman

July 31, 2018

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

reason FOUNDATION

Re: Comments on ASOP4 Exposure Draft

Dear Members of the Actuarial Standards Board,

Thank you for the opportunity to comment on the *Proposed Revision to Actuarial Standard of Practice (ASOP) No. 4* ("ASOP4"). The Pension Integrity Project at Reason Foundation offers pro-bono consulting to public officials, labor associations and other stakeholders to help them design and implement policies that improve public plan solvency and promote retirement security for public sector employees. As such, we frequently interact with public plan actuaries and are a robust user of public pension data from systems nationwide.

As individuals interested in advancing sound policymaking and the cause of public pension solvency, we write today in support of the proposed changes to ASOP4. The proposed changes would clearly enhance financial transparency and would facilitate a useful side-by-side analysis of even very disparate plans using a common set of assumptions. Further, implementing the proposed revisions would significantly advance the public's understanding of pension risks and liabilities, which will ultimately lead to better decision making.

While we do support the overall intent of ASOP4, in our view the best practice would be to use U.S. Treasury Yields as a proxy for the discount rate, not yields on highly rated fixed income securities in the calculation of the proposed Investment Risk Defeasement Measure (IRDM). Using Treasury Yields alone would result in a more standardized measurement across plans. Further, the proposed language allowing for use of fixed income securities runs against Congress' intent reflected in Section 939A of the Dodd-Frank law, which writes ratings out of federal regulations. The term "recognized rating agency" is not defined, but likely would be interpreted as an SEC-licensed nationally recognized statistical rating organization (NRSRO). There are ten such rating agencies which evaluate risk in different ways. As a result, yields on fixed income instruments carrying the top two NRSRO ratings will likely fall within a broad range, resulting in the possibility of large variance from one IRDM discount rate to the next depending on what definition the actuary selects for determining the IRDM.

Thank you again for the opportunity to submit comments in support of changes to ASOP4. Please do not hesitate to reach out if additional information would be useful.

Sincerely,

Leonard Gilroy
Senior Managing Director
Pension Integrity Project
leonard.gilroy@reason.org

Anthony Randazzo
Senior Fellow
Pension Integrity Project
anthony.randazzo@reason.org

Comment #41 – 7/31/18 – 11:27 p.m.

Dear Members of the Actuarial Standards Board:

The Civic Federation is writing in support of proposed revisions to Actuarial Standards of Practice (ASOP) Nos. 4, 27 and 35. The Civic Federation, founded in 1894, is a non-partisan government research organization that works to maximize the quality and cost-effectiveness of government services in the Chicago region and State of Illinois. For many years, the Civic Federation has written about our area's public pension plans and posted our reports on the Federation's website. Our research relies heavily on the actuarial valuations published by our region's retirement systems. As President of the Civic Federation, I served on the Society of Actuaries' Blue Ribbon Panel on Public Pension Plan Funding, which issued its report in February 2014.

The Civic Federation supports the expanded disclosure requirements contained in ASOP Nos. 4, 27 and 35 in order to increase transparency and comparability of public pension plans and improve public understanding of their financial condition. We note in particular that the proposed Investment Risk Defeasement Measure in ASOP No. 4 is in line with the Blue Ribbon Panel Report, which recommended disclosure of plan liability at a risk-free rate to quantify the risk inherent in plans' investment policies. As consumers of actuarial valuations, the Civic Federation would find comments from the actuary on the reasonableness of assumptions a useful supplement to work already being done by the Illinois State Actuary for the State funds and the Chicago Teachers' Pension Fund and would assist the Federation in making recommendations to sponsoring governments about pension-funding policies.

Thank you for the opportunity to comment on the proposed revisions. Please do not hesitate to contact me at 312-201-9044 if you have any questions.

Sincerely,

Laurence J. Msall

Laurence Msall
President

Laurence Msall | President
The Civic Federation

July 31, 2018

Via e-mail: comments@actuary.org

Actuarial Standards Board
1850 M Street, NW, Suite 300
Washington, DC, 20036

Re: Comments on exposure drafts for Actuarial Standards of Practice (ASOPs) 4, 27 and 35

Members of the Actuarial Standards Board (ASB) and the Pension Committee of the ASB:

As the former Chair of the SOA's Blue Ribbon Panel on Public Pensions (BRP), I would like to thank you for undertaking this significant update and upgrade of the ASOP's relevant to the practice of pension actuarial services. My view, which has not been considered by the former members of the BRP, is that, together with ASOP 51, the proposed changes represent a significant and desirable strengthening of the standards in this important area of actuarial work.

Specifically, I strongly support the requirement to disclose the investment risk being assumed by the plan through the calculation of the Investment Risk Defeasement Measure (IRDM) included section 3.11 of the ASOP 4 exposure draft. This measure is consistent with the recommendations of the BRP. I also suggest that this measure be extended to the calculation of the plan's contribution using the same measurement basis as the IRDM, i.e., funding method and discount rate. The availability of both the aggregate and the annual risk of assuming returns in excess of more readily achievable returns provide important, useful and understandable information regarding the level of risks embedded in the plan's funding program.

I also recommend that the guidance concerning the development of amortization methods (Amortization Method, section 3.14, ASOP 4 exposure draft) be strengthened to prohibit any negative amortization; currently the guidance only states that the actuary must consider the "length of time until amortization payments exceed nominal interest" (3.14.b.i). In addition, I suggest that guidance concerning the period of amortization more strongly recommend that such period should be consistent with the average expected future working life of the employees so that promised benefits are fully funded upon retirement; again, currently, it is just a factor for consideration (3.14.b.ii, "duration of the actuarial accrued liability").

Finally, I strongly support the requirement for the actuary to provide information and analysis used to support their determination that the assumptions are reasonable (Rationale for Assumptions, section 4.1.2, ASOP 27 exposure draft). The draft language states "For example, the actuary may disclose any specific approaches used, sources of external advice, and how past experience and future expectations were considered in determining the assumption to be reasonable." I recommend that the language stating an actuary 'may' disclose specific approaches, sources of external advice, and other bases for their conclusion be strengthened to a 'should disclose' standard. In this regard, I believe it is critical that users have a full understanding of how the actuary reached their conclusion that assumptions are reasonable.

Thank you for making these important changes to the ASOPS covering pension practice. I hope that my suggestions will contribute to further improvement in practices and the transparency of the work being performed.

Robert Stein
Former Chair of the SOA Blue Ribbon Panel on Public Pensions

July 31, 2018

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

Dear Board Members:

We the undersigned are credentialed actuaries who do substantial valuation work for public sector pension plans. We are submitting the following comments on **Section 3.11** of the exposure draft of proposed revisions to Actuarial Standard of Practice (ASOP) No. 4, *Measuring Pension Obligations and Determining Pension Plan Costs or Contributions*. These comments are being submitted to the ASB by us as individuals and do not necessarily reflect the views of any actuarial organizations to which we may belong, or of our respective employers.

We urge the ASB to acknowledge that the IRDM, in addition to being effectively a settlement measure, is also the value known in the financial economic literature as the "Solvency Value"[1], and to consider the policy implications of making that value a universally required disclosure. In particular, we urge the ASB to consider the **risk of misrepresentation** of the IRDM that would result from the ASB imposing mandatory disclosure of a solvency/settlement value (however it is characterized) in reports prepared for funding purposes by pension plans' retained actuaries. Such misrepresentations would mislead the public and possibly impair the reputation of the actuarial profession.

For years, some proponents of financial economics have claimed that the solvency/settlement value is the only true value of any pension obligation, and that actuaries, specifically those serving public pension plans, are misstating the true cost of pensions by performing funding valuations based on expected investment returns. In the current low interest rate environment, actuaries have been accused of understating costs in the funding valuation. In a high interest rate environment, they would be accused of overstating costs (which some of our signatories recall has happened in the past). For the ASB to select the solvency/settlement value as the sole, prescriptive measure to be universally required in all pension valuations may appear to confer the authority of the ASB upon these claims. We believe this could happen even if the ASB characterizes the value as only a measure of risk defeasement or settlement.

Thus, the IRDM disclosure requirement would require every funding valuation to include work product for which there is substantial evidence that it will be used to mislead the public, despite any explanations or limitations that are provided with the disclosure. Furthermore, we are concerned that the ASB's apparent endorsement of the solvency value through the extraordinary action of prescribing its disclosure in all actuarial valuations could embolden claims that the funding valuations are deceiving the public by misstating costs (relative to the IRDM), thereby impairing the reputation of the actuarial profession.[2]

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[1] Note for example that the February 2016 "Report of the Pension Task Force of the Actuarial Standards Board" refers to the IRDM as the Solvency Value.

[2] The risk of "misquotation, misinterpretation, or other misuse" of actuarial work product so as to mislead the public is an important enough issue to warrant a precept (Precept 8) of the actuarial Code of Professional Conduct. While we are not proposing that the disclosure of a solvency/settlement value would incur a breach of that precept, we would ask the ASB to consider our concerns in the spirit of Precept 8 of the Code.

Sincerely,

Paul Angelo, FSA, MAAA, FCA, EA
David L. Driscoll, FSA, MAAA, FCA, EA
Douglas Fiddler, ASA, MAAA, FCA, EA
William B. Fornia, FSA, MAAA, FCA, EA
William R. Hallmark, ASA, MAAA, FCA, EA
Koren L. Holden, MAAA, FCA, EA
Leon F. Joyner, Jr., ASA, MAAA, FCA, EA
Piotr Krekora, ASA, MAAA, FCA, EA
David Lamoureux, FSA, MAAA, FCA
Fiona E. Liston, FSA, MAAA, EA
Thomas B. Lowman, FSA, MAAA, FCA, EA
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July 31, 2018

Actuarial Standards Board
1850 M Street, NW, Suite 300
Washington, DC 20036
RE: Proposed Revision of Actuarial Standard of Practice No.4

Dear Members of the Board:

As a member of ACOPA, and as a pension actuary in practice for over 45 years, I wish to add my comments and concerns on proposed ASOP 4. My comments are both of a professional actuary and as a private citizen. My experience includes multi-employer and single employer plans of all sizes, and as a speaker educating members of the public on public pension plans.

The most relevant purpose of ASOP 4 is, in my opinion, to require the actuary valuing pension benefits to disclose relevant liabilities of the deferred benefits of the plan or scheme under review. These include benefits already earned and possibly future benefits to be earned.

The users of this information will need to assign these liabilities to relevant periods, both for funding of benefits and for disclosure of potential future events. These may include:

- contribution requirements,
- budgets,
- reassurances to beneficiaries,
- financial viability of principal parties (such as lending risks),
- transfer of responsibility between principals (such as plan terminations, de-risking, lump sum payouts, mergers and spinoffs),
- audit of plan operations including analysis of gains and losses.

Why do we need this standard?

This proposed ASOP extends existing standards, especially to include IRDM for plans that have not used such measurement historically. ERISA plans for single employers are already subject to a form of this method of measurement, but with a modified standard for discount rates. If covered by PBGC, the duration-sensitive bond rates of high quality corporate bonds is required. For minimum funding standards under IRC 430, more optimistic rates are required that reflect a long 25 year smoothing of rates.

Under IRC 431, multi-employers plans have currently no such standard. Exempt church plans have no such standard. Public plans have standards set by their governing laws in many plans, but no standard for disclosing the specific funding level of promises already matured as the IRDM would require.

Practical Concerns

Plan sponsors, and their interested parties that have not complied with a form of disclosure similar to IRDM in the past, will find that there are consequences of adopting this ASOP 4.

- First, there will be transitional costs for determining the method and format of disclosure.
- Second, the responsible actuary will initially incur additional work until their procedures and business practices can be responsive to the standard.
- Third, the plan sponsor will have more public dialogue explaining the new information, which will result in more administrative expense. This would include discussion of smoothed funding procedures compared to the fluctuations that will occur once ASOP 4 is implemented.
- Fourth, policy makers will be confronted with pressure for change in plan benefits, investment decisions, and commitment to fund promises made. This might affect benefit negotiations as well. As the homily goes: if you find you are in over your head, stop digging.

I find none of these concerns to be so serious that the profession should back away from a standard that informs the various publics, including beneficiaries.

The proposed standards might cause policy changes that disrupt established policies, but that is the purpose of a standard that is well understood. Plan sponsors and their advisors do not serve the public or the profession by arguing that these measurements are time-consuming or irrelevant to their operation. Plan liabilities should be tied to the period of time when they emerge, so costs are not hidden and so that funding of benefits corresponds to the events that created the liability.

Some Historical Perspective

My history includes many years of experience before the legislated standards set the funding method for private single employer plans. Many of those old funding methods served to set a method of recognizing pension costs that might not have measured current funding status, such as Aggregate, Individual Aggregate, Frozen Initial Liability, and others that were of no use in determining the safety or adequacy of current assets to provide the benefits. Many of the plans currently exempt from ERISA standards have a similar lack of information. The adoption of ASOP 4 as drafted is an important step in full disclosure.

The accounting profession made some improvement in such disclosures for published financial statements when Accounting Standards were issued under FASB Opinion 87, and thus created a standard that measured current funded status under an ongoing-plan scenario. For example, they did require the actuary to disclose some valuable information on how assumptions were set.

This did not create a standard that was sufficient when consideration of settlements of liability transfers is contemplated, as that was the purpose of FASB Opinion 88. Even though disclosures did allocate plan liabilities to past, current, and future liabilities, the standards rarely caused disclosure of market values, since it was usually tied to long term discount rates and expected investment returns. Further, many plans were not subject to these standards.

For public plans, GASB made significant progress in consideration of liabilities and their supporting funds, placing liabilities into two categories, those covered by assets are valued at a long term expected rate, but those not covered by current assets are valued at the rate available to the plan sponsor to borrow in the capital markets. This was a significant challenge to the actuarial providers, but the industry demonstrated that a change of this magnitude could be managed in a timely manner. This lends credence to the point that IRDM can be implemented without undue turmoil.

Justifications For Discount Rates

Public discourse includes many different audiences. The investment community became interested in pension funding disclosure after finding that pension liabilities had often been understated before actions were taken, such as derisking, plan termination, and other events where benefits had to be priced to attract principal parties to accept the responsibility of the benefits, and promised financial disclosures proved to be wildly optimistic. Investment theory noted that pension obligations were senior to most other debt, and enforced by PBGC and civil suits brought by participants. It is a widely held view at the national policy level that employers are liable for benefits to the extent of their ability to pay, regardless of other parties and their interest in plan sponsor assets. Failure to fund benefits is a policy action on plan sponsors that has consequences.

However, the consequences cannot be held against entities that no longer have the resources to meet their promises, including bankrupt sponsors. This occurs in all types of public, single employer, multi-employer, and church plans. Disclosure under ASOP 4 of the funded status of a plan is key to solving funding problems as early as possible. This is fully in the public's interest, both for the protection of plan beneficiaries and for those who supply capital assets to plan sponsors.

I observe that IRDM as proposed is based on a risk-free discount rate, which I observe as the most conservative of possible measures. This is consistent with capital market theory in many schools of finance. Other measures have been used, including historical averages of actual investment results, PBGC or IRS published rates, insurance company guaranteed rates, or immunized bond portfolios. In my opinion, each of these rates include some provision for external economic forces, especially inflation expectations, but also market fluctuation in the availability of capital. Some of that is based on market demand for lending, some is based on Federal Reserve policy, or on needs for federal debt, which can affect market demand. I would prefer that liabilities be valued at both a current rate and the prior year rate, so the public has information on the effects of capital market changes.

A market interest discount rate can and usually would fluctuate, sometimes dramatically from year to year, and the choice of discount rate should not be the province of the plan sponsor nor the beneficiaries because of the divided loyalty between participant security and capital market needs, including managing profits.

For the purposes of measurement, I would consider a standard using actual yields less inflation, viewed over a business cycle of at least five years that includes a period of market correction, based on compound yield (geometric mean). This rewards plan sponsors who have a successful record of competent investment management.

However, measurements appropriate for de-risking, settlement, and similar actions should be tied to current pricing models of principal parties who can accept full liability for promised benefits, including PBGC and insurance annuity products. For example, CALPERS uses a model for discontinuing plan sponsors in which earned benefits are valued at a discount rate that CALPERS considers highly likely to achieve, not on expectations that plan sponsors can correct underfunding from future contributions which are no longer available.

Other Considerations

One final point: bad examples come from bad policies and standards. Look at plans that have a long spread period to amortize past benefit liabilities, or the temptation of operating groups to generate immediate liabilities and never fund them (e.g., via negative amortization or refusal to pay the actuarially determined cost). Generous bonuses and unexpected compensation increases are often the cause of liabilities that do not fit in the current model used by plans using such funding methods as Entry Age Normal. Few actuaries would consider it reasonable to have an assumption for compensation to double in the year of benefit determination.

To hold the stakeholders accountable for their actions, I believe that IRDM measurement should be applied to individual participants, and those with substantial actuarial liability increases should be charged directly for their actions within the next measurement period as an immediate loss. This is especially true when considering such actions as hiring a senior manager with substantial past service credits, or when paying additional compensation based on overtime or accrued sick leave. The actuary should measure such events and be able to explain what actions caused a sudden liability increase. A version of this policy has been tried in Illinois when compensation grows more than 6%. A policy which ties the budget of an operating unit to their actions is needed.

Thank you for the opportunity to comment.

Via Electronic Mail

July 31, 2018

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

To the Members of the Actuarial Standards Board:

On behalf of Cheiron, Inc. the following are our comments on the exposure draft of proposed changes to ASOP No. 4 that was issued in March 2018. We appreciate the work and effort put in by the ASB Pension Committee to develop this exposure draft based on the recommendations of the Pension Task Force and the direction of the ASB. We also appreciate the opportunity to provide comments and look forward to a second exposure draft on these important changes.

The exposure draft proposes a number of changes to ASOP No. 4. While some of the changes are an improvement, others will cause confusion and be difficult to implement. Our comments are divided into two parts. The first concerns the proposed investment risk defeasement measure. The second concerns other proposed changes.

Part 1 – Investment Risk Defeasement Measure (IRDM)

The most significant proposed change to ASOP No. 4 is the requirement to calculate and disclose an "Investment Risk Defeasement Measure" (hereafter referred to as the IRDM) when the actuary is performing a funding valuation. In essence, as defined, the proposed IRDM is a Market-Consistent Present Value as currently defined in ASOP 4.

We believe that the requirement to calculate and disclose an IRDM should be dropped from any final revision of ASOP No. 4. There are a number of reasons for our belief, which will be briefly discussed below.

1. Pension actuaries already make a number of calculations for various types of plans, many of which are similar to the proposed IRDM. For example, under the Federal laws pertaining to pension plans,[1] a "current liability" is determined for multiemployer plans, and a "funding target" is determined for single-employer plans each of which is a Market-Consistent Present Value. These calculations are made for a purpose under the applicable law. Calculating yet another Market-Consistent Present Value, that has no particular application and provides limited or no additional value, makes no sense and will confuse the recipients. There appears to be no purpose for the calculation.

[1] The Internal Revenue Code and the Employee Retirement Income Security Act of 1974 (ERISA), as amended.

2. The IRDM requires the actuary to use a funding method that would not otherwise be used for a number of plans. For example, the funding method used for public plans most often is the entry age normal method. However, the IRDM must be calculated under the unit credit method. There is no corresponding value with which to compare the IRDM.

3. ASOP No. 51 provides for the assessment and disclosure of risk associated with the measurement of pension obligations. The impact of ASOP No. 51 should be assessed before even thinking about mandating a specific measurement that purports to measure investment risk.

4. Since our formation in 2002, we have used projections and stress testing along with other measures to educate trustees and other stakeholders about the risks to which their plans are exposed, enabling them to better manage those risks, most notably investment risk. Based on our experience, we believe stress test projections are better, and that the IRDM is not the most important and useful measure of investment risk. We are concerned that its required disclosure will inhibit the understanding and management of investment risks rather than help.

   There is no evidence that the disclosure of an IRDM would help. Current liability has been calculated and disclosed for multiemployer plans since 1987, and we discern no impact upon the management of investment risk due to that disclosure.

   Public sector defined benefit plans have been under attack from various directions. The attacks have relied upon market value type measures to portray public sector plans as unaffordable.[2] We are concerned that the critics will seize upon the IRDM as the "one true measure" of the liability and continue to mislead the public when most public plans can never be forced to settle their obligations. In the long run, the requirement for an IRDM will hurt, not help, the reputation of the actuarial profession.

5. Public sector plans are required by Governmental Accounting Standards Board (GASB) statements 67 and 68, as modified, to provide liability values using both an interest rate one percent higher and one percent lower than used in the valuation. The required "+/- 1" values already allow estimation of the liability at other rates.

6. The IRDM makes use of an "accrued benefit." Many plans will not have a set definition of accrued benefit. The accrued benefit is a defined term in ERISA. It is not a defined term for plans not subject to ERISA. For such plans, determining what is the accrued benefit presents conceptual and legal challenges that go far beyond the actuary's scope in his or her assignment. Consider, for example, a public plan that promises a benefit based upon final average pay and years of service and that cannot be changed for current employees, even for

[2] For example, one author merely compared the current asset values to the estimated value of current benefits earned without considering that contributions were ongoing. (Even worse, another paper compared the actuarial accrued liability as if it were a current value of benefits instead of a cumulative measure of past normal costs to non-cumulative current revenues to claim that pension benefits were increasing faster than revenues, and blamed the plan sponsor for increasing pension benefits.)

the future, under the state constitution. Is the accrued benefit based upon years of service to date and current pay, years of service to date based upon future pay, or some other measure? A public plan may also provide a cost of living adjustment (COLA), and by combining a long-term COLA assumption with observed short-term yields, the value of the COLA could be grossly overstated. As another example, consider a multiemployer plan that provides that the benefit is a dollar multiplier for each year of service, but that the multiplier at the end of the two-year period after the termination of service will be used if it has increased.[3] In essence, a participant is promised a benefit for service to date based upon a multiplier that is set in the future.

7. The proposed IRDM presents a misleading picture of variable benefit plans where the benefit is adjusted for investment performance. Under variable benefit plans, investment risk is shared with the plan participants by benefit adjustments. [4]

Part 2 – Other Proposed Changes

The proposed changes to ASOP 4 in sections 3.14 and 3.16 are overly prescriptive and lead to the development of a detailed rulebook. However, we have suggestions for modifications of those detailed rules if the ASB insists upon this approach. We also suggest an alternative approach that avoids writing a rulebook into the standards, and instead defines criteria for an actuarially determined contribution (ADC) to be considered reasonable.

Amortization Methods – Proposed Section 3.14

Proposed Section 3.14 would provide guidance on amortization methods selected by the actuary. It would require that the amortization method either produce payments that exceed nominal interest on the unfunded actuarial accrued liability, or satisfy a number of conditions. The conditions are (a) that payments do not increase, or do not increase more rapidly than expected covered payroll, and (b) the payments fully amortize the unfunded actuarial accrued liability within a reasonable time-period. A reasonable time-period depends on the consideration of a number of factors.

Many amortization methods determine the amortization period separately for identified portions of the change in unfunded actuarial accrued liability and a separate amortization base is set up.[5] This is often referred to as "layered amortization." We suggest that the conditions of Section 3.14 be applied separately to each portion of the unfunded actuarial accrued liability with its own amortization period. This is important because, over time, as one amortization base becomes fully amortized (such as a base for an experience gain); the net payments required by the remaining bases may exceed the increase in covered payroll. The combination of layers may also result in temporary negative amortization even though each individual layer does not.

[3] The undersigned has seen one such plan, which still exists.
[4] Recently, the Society of Actuaries recognized our work with the state of Maine as a winning submission to its *Retirement 20/20* Call for Models for Public Pension Plans Contest. See https://www.soa.org/press-releases/2018/retirement-20-20/.
[5] Separate bases may be required under ERISA for certain types of plans, and have been in the past.

Section 3.20 - Reasonable Actuarially Determined Contributions

Proposed Section 3.20 would require that an actuary performing a funding valuation that does not include a prescribed assumption or method set by law, to calculate and disclose an ADC using a contribution allocation procedure that satisfies a number of conditions. The conditions include a requirement that if an actuarial cost method with individual attribution is used, then the normal cost for a participant should be based upon the plan provisions applicable to that participant. We understand that the intent of the condition in the previous sentence is to preclude the use of an "ultimate entry age normal cost."

Because plans subject to ERISA have at least one prescribed assumption or method set by law, the requirement to make and disclose an ADC does not apply. Thus, it appears that Section 3.20 is directed at plans not subject to ERISA, and is directed at public plans in particular.

Rather than providing detailed rules for each of the components of an ADC (i.e., amortization method, asset smoothing method, and output smoothing method), we think the standard should describe principles to which a reasonable ADC should adhere. Using a framework similar to that in ASOP 44 for asset smoothing methods, we suggest that the ADC be required to meet the following two criteria:

1. The ADC is greater than the normal cost plus interest on the unfunded accrued liability (measured on the market value of assets) or is expected to be greater within a sufficiently short period of time, and

2. The ADC is expected to pay off the unfunded accrued liability (not surplus) or come within a sufficiently narrow range in a reasonable period of time.

As long as the ADC meets these two criteria, we should not care about the details of the amortization method, the asset smoothing method, or any output smoothing methods. The details of how to construct these methods are better left to practice notes or white papers and should not be a part of the standards of practice.

Section 3.21 Gain and Loss Analysis

Proposed Section 3.21 would require an actuary performing a funding valuation to perform a gain and loss analysis for the period between the last measurement date and the current measurement date, unless in the actuary's professional judgment, successive gain and loss analyses would not be appropriate for assessing the reasonableness of the assumptions. Proposed Section 3.21 would further provide that, if a gain and loss analysis is performed, the actuary should at least separate the total gain or loss into investment gain or loss and other gain or loss.

We believe that the proposed Section 3.21 should either be dropped from the final revision, or that the requirement be that the actuary should consider whether to make a gain or loss analysis, or should consider whether to separate the total gain or loss into investment components and other components. In many cases, a gain or loss analysis makes no sense. Consider a single-employer plan where the funding valuation is based upon prescribed interest rates and a prescribed mortality table. Each year a single amortization base is determined (if there is a "funding shortfall") and amortized over seven years. That single amortization base reflects, at a minimum, the gains and losses, and the change in prescribed assumptions from the previous valuation. There is no usefulness to a gain and loss analysis in this situation.

In other cases, a gain and loss analysis will add additional cost and little benefits. Consider a situation where the aggregate cost method is used for a multiemployer pension plan. A normal cost is developed as a percentage of pay by taking the present value of future benefits, subtracting the value of the assets, and then dividing by the present value of future payroll. The percentage is applied to pay to get the normal cost as a dollar amount. The gain and loss from year to year is imbedded in the changes in the normal cost percentage. However, that percentage change reflects other factors as well, such as plan changes and assumption changes. Separately determining a gain or loss is complex, costly, and not needed.

For a public plan, the requirements of GASB Statements 67 and 68 already require that the investment gain or loss be identified separately from other gains and losses. Thus, the calculation and disclosure sought by proposed Section 3.21 is already being made.

Applicable Law

The current ASOP 4 has many references to applicable law and carefully clarifies the term with the parenthetical "(statutes, regulations, and other legally binding authority)." The proposed revision would delete the parenthetical statement everywhere except in a paragraph in Section 1.2. The definitions do not define the term "applicable law."

We believe that the elimination of the parenthetical could be regarded as meaning the following regulations and other legally binding authority is no longer considered part of applicable law in the various sections of ASOP 4 where the term is found. We believe that result is not intended. We suggest that a definition of applicable law be added to Section 2 and that the definition include the parenthetical "(statutes, regulations, and other legally binding authority)."

If you have any questions or would like to discuss this letter, please feel free to contact me at 703-896-1456, extension 1039.

Sincerely,
Cheiron

James E. Holland, Jr.

James E. Holland, Jr., FCA, FSPA, ASA, MAAA, EA
Chief Research Actuary

July 31, 2018

VIA ELECTRONIC MAIL

Actuarial Standards Board

1850 M Street, NW, Suite 300

Washington, DC 20036

Re: Actuarial Standard of Practice No. 4 Exposure Draft

To Members of the Actuarial Standards Board:

Thank you for the opportunity to provide comments on the ASOP 4 exposure draft. I would also like to thank the pension committee for its hard work over the years in bringing important areas of practice into the ASOPs in a thoughtful and deliberative fashion. It has always been my understanding that the ASOPs provide guidance to steer the actuary's decisions towards what the consensus of the pension community feels is appropriate practice. For the most part, the changes proposed to ASOP 4 accomplish this task. There is one proposed change which does not do so and this will be the primary focus of my response.

The mandatory disclosure of a market value of liability (in whatever guise you clothe it) is most decidedly not appropriate practice in the pension arena, nor is it emerging practice nor is it best practice. Neither is the inclusion of this requirement a result of the usual deliberative process that has gone into the development of ASOPs in the past. The inclusion of this requirement is being forced onto the pension actuarial community by outside elements and over the objections of those of us who practice in this area.

As part of the ASB pension committee from 2009 through 2015, I was involved in helping to effect many substantial changes to the pension ASOPs up to and including the release of ASOP #51 on the measurement and disclosure of risk. All of these changes went through the standard process of coming to the pension committee for deliberation, being discussed by a variety of practitioners from all areas of pension practice before they were carefully crafted into an exposure draft.

During my time on the pension committee we had discussions about measuring a market value of liability (MVL) and released a discussion draft of ASOP 4 which included a sample of how such a measurement could be produced. Comments came in generally negative and many felt that including the MVL in the ASOPs was not appropriate since the standards are supposed to follow practice and there is no requirement nor any practice of disclosing this type of measurement. The pension committee received so much push back from the pension actuarial community that this "straw man" was removed from consideration. At that time we understood the difficulty of even defining such a measurement and did not consider the even more radical step of making it a mandatory disclosure. Rather than going forward with the development of a practice-wide definition of an MVL measurement, ASOP 27 was edited to make it clear that those who wish to disclosure and MVL would not be in violation of the ASOPs should they choose to do so.

Give the new and revised ASOPs time to work

Many valuable changes have been made to the ASOPs in recent years to improve disclosures and hold actuaries accountable for funding assumptions and methods. These changes, coupled with public discourse on the issues of public sector funding and changes required by the accounting profession have made a difference in the public sector market where actuarial return assumptions have been decreasing and understanding of funding dynamics have been improving. ASOPs requiring the actuary to disclose assumption rationale have only been in place a short while, as have requirements that the actuary provide an opinion on the ability of the funding method to pay off UAL. These additions to the ASOPs will continue to strengthen both actuarial practice and disclosures in all pension valuations.

ASOP 51, on measuring and disclosing risk, will not even be effective until the 2019 valuations for most of my clients so it seems too soon to be making additional and stringent changes to the ASOPs before this new standard has even had a chance to work. It is my belief that the implementation of the risk ASOP will continue to change actuarial practice for the better and must be given time to work. I urge the ASB not to rock the boat and erase the effort that went into getting to ASOP 51 by mandating such a divisive and harmful disclosure as one based on MVL.

Reputational Risk

I have yet to hear anyone express a coherent reason why an MVL needs to be disclosed, nor do I understand the impetus behind whoever is pushing this. Some have made vague references to "reputational risk" if we continue to perform actuarial valuations without such a disclosure. What exactly is the reputational risk? Some refer to the news articles on the underfunding of public sector pension plans and seem to indicate that this is the fault of the actuary or the actuarial methods. Nothing could be further from the truth.

There are a handful of very poorly funded public sector pension plans which make the news periodically. Most of these poster children for underfunded pension plans got that way due to plan sponsors not making the annual contributions that the actuary indicated were needed. Most public sector pension plans are not like these bad boys and they should not be punished for the acts of a few. In fact, the disclosure of this metric would do nothing to improve the funding situation of those poster children but would only hurt plans that have taken ownership of their funding and are making progress.

Rather than standing up for its members when faced with misinformation, it seems leaders of the SOA turned on their own profession and sided with the forces trying to stamp out public sector DB pension plans. The SOA formed the so-called blue ribbon panel, which included only one practicing pension actuary. Even that one pension actuary was likely chosen because he was well known for publishing MVL numbers in his plan's financial reports, a practice that was stopped by his successor after his retirement. The panel came out in favor of MVL disclosures because they were chosen in such a way as to drive that result.

The ASB similarly has not stood up for its members but rather formed the Pension Task Force, which consisted of individuals who were hand-picked by the ASB to serve with no transparency about why these individuals were chosen. I contend that they too were chosen to produce the outcome desired by whoever is driving this effort to undermine public sector pension plans by requiring an MVL disclosure.

Why were the responses to ASB request for comments funneled through this ad hoc body and not the pension committee? The pension committee is made of actuaries who represent a broad swath of pension practice by area (public, private, Taft-Hartley, etc.) by company size, by gender and by experience.

The changes already made to the ASOPs, up to and including the risk ASOP, were designed by people who practice in the pension field as the best way to address any perception of reputational risk. If the ASB takes the step to require disclosure of a number that will inflame the discussions surrounding public pension plan funding this would only ***create*** reputational risk. The profession's reputation would be harmed by forcing actuaries to disclose a number that can be misused in the debate surrounding public plan funding and which those very actuaries cannot adequately explain the need to disclose. Instead of forcing this disclosure why not stand up for the actuarial professionals that practice in this arena and make it clear that while we can (and do) disclose all kinds of measures and projections about public sector plan funding we cannot force the plan sponsor to make contributions to these plans. The ASB and others would better serve the actuarial profession by standing up for the pension industry rather than bowing to external forces seeking only to harm defined benefit plans. We need stronger support from our profession to get out the word that these is no one single number that measures the true liability of a pension plan.

By mandating the disclosure of an MVL this single measurement is likely to be perceived as "the one true" measure of liability. Our reputation would be damaged by all the questions about why this was never used in the past, and if it is the one true measure, then why isn't it being used in funding calculations? Where MVL has been mandated in pension funding it has been watered down. In 2006 the federal funding laws governing private sector plans mandated the use of a 24 month bond yield curve for measuring liabilities. By the time the first valuations were being performed under this new law the bottom had fallen out of the bond markets and bond yields were being held artificially low by Fed action. The move to use these ultra-low bond yields was deemed too costly to implement so the law was changed "temporarily" to allow for use of rates within a collar around the 25 year average yield instead. This "temporary" relief has been extended twice now and is likely to be extended again when the current period runs out. As far as I can see this was a failed experiment in the use of MVL. Since this failed so spectacularly what argument is there to extend the use of MVL into other areas?

A lot of the discussion surrounding this disclosure has centered on the idea that current funding disclosures are understating the liability of defined benefit pension plans. What if an MVL disclosure is required just as the economy hits double digit inflation, as occurred during the 1970s and 1980s? If the market value of liability is significantly lower than the funding liability will those who required its disclosure then argue that public sector pension plans are not generous enough? Will this lead to putting back all of the benefits cuts that have taken place since the 2008-09 recession? Use of a more consistent measuring stick (i.e. a discount rate based on the long-term expectation of investment returns) avoids such see-sawing behavior.

<u>The Process</u>

It seems that the process for updating ASOPs has been turned on its head in order to get this mandate into the exposure draft. The time honored tradition has been for the ASB's practice committees to identify a need to improve the language in ASOPs in response to perceived deficiencies or to keep up with evolving practice. This change was specifically directed by the ASB and did not bubble up from the pension committee. This sets a dangerous precedence for those without the appropriate credentials to direct the operating requirements of specialty areas.

The way in which this item was inserted into the exposure draft is serving to politicize a process that has been carried out in a much more circumspect way for decades. Why do this?

Public Sector Pension Plans and GASB

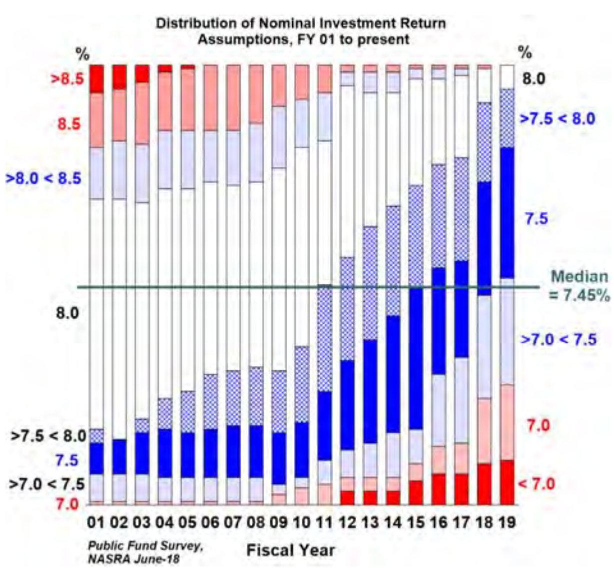
Even if the ASOPs were to require a public sector actuary to calculate and disclose an MVL there is no guarantee that such a number would go any further than the actuary's disclosure. Public Sector plans make annual financial disclosures in accordance with rules promulgated by the Governmental Accounting Standards Board (GASB). GASB went through a process to change those rules along the following timetable:

August 2009 – GASB holds public hearing to gain input on how their PERS accounting rules should be changed

June 2010 – GASB releases preliminary views which embrace the use of the expected return on invested assets and rejects the use of MVL measures

June 2012 – GASB releases new standards 67 and 68 on pension plan disclosures to be effective the first plan year beginning on or after 6/15/2013. For most PERS this meant for the 2014 fiscal year

GASB's endorsement of using the expected earnings on invested assets, coupled with their additional requirements on disclosing the building blocks of this assumption seems to have begun a movement towards these plans using lower discount rates as can be seen in the following graphic, produced by the National Association of State Retirement Administrators. The first big step took place shortly after GASB published their Preliminary Views and the process has been continuing.



GASB standards also require the disclosure of liability with interest rates +/-1% of the discount rate used in the base valuation. This should provide enough information for those interested in seeing the liability at a lower rate to perform the estimate themselves. GASB 67 has only been in effect for 3 years so this information was not readily available during much of the process that lead to these changes being proposed. This is yet another instance of the need for giving time for changes that have already been made to work before forging ahead with this new requirement which will cause more harm than good.

Public sector DB pension plans are one of the last areas of employment for pension actuaries, thanks to the volatility of private sector funding rules driving those plans to terminate. The imposition of the required MVL disclosure as part of every funding valuation could lead to this industry turning elsewhere for its funding calculations. If actuaries can continue to produce GASB reports without making the MVL disclosure it is a possibility that this is the only area in which public sector plans would be willing to hire an actuary. Once the GASB work has provided the basic building blocks it would be simple for a non-actuary to take the liability and normal cost and use these to prepare the funding calculations, thus avoiding any MVL disclosure requirements.

Technical Flaws

The name given to the MVL disclosure in the exposure draft would seem to indicate it is a risk measure. Apart from the obvious question that if this is a risk measure then why is it not in the Risk ASOP, I have to ask how such a measure provides any information about risk? There is no companion measurement of the same liability made using the long-term valuation assumptions and without anything to compare it to the measure fails in its stated purpose of showing the plan sponsor anything about the risk they are taking on. By its definition it appears to be more of a settlement liability. While settlement is an option in many types of pension plans it has little or no relevance in the public sector pension world.

Requiring this disclosure is clearly an unfunded mandate by the profession on practitioners in the public sector in particular. Currently, there is no reason to measure liability on an accrued benefits or vested accrued benefits basis. Private sector and multiemployer plans have been measuring this type of liability for years since it is a requirement for funding calculations and PBGC premium payments. There is no public sector equivalent to either define an accrued or vested benefit (what is forfeitable varies by the governing jurisdiction and is subject to litigation every time it comes up). In order to measure an MVL it would take a great deal of discussion and programming even to produce this result and we would be hard pressed to get our clients to pay for such a result if our only justification is that the actuarial profession requires us to do so.

Even more time and effort would have to be expended in explaining to our public sector clients what this number represents and what it doesn't represent. Should they include the disclosure in their own reporting we would have to assist them in crafting a message to the ultimate users of their publications.

Too Prescriptive

The ASOPS recognize that there is no "one size fits all" definition of liability. This is why they focus on choosing assumptions and methods that are appropriate to the purpose of the measurement. This MVL disclosure requirement goes in the opposite direction and is far too prescriptive to be in an ASOP.

The requirement at those performing a funding valuation must also calculate and disclose an Actuarially Determined Contribution is also too prescriptive for the ASOPs as are the specific requirements for that ADC as found in items 3.14.

3.14 sets parameters around the choice of an amortization method. It seems that existing ASOP section 4.1(k) is an adequate reminder that actuaries should think about the impact of the amortization methods being used without being as prescriptive as this section is trying to get.

Section 3.12 and the companion disclosure requirement are also too prescriptive for an ASOP. It should be left up to the actuary to decide whether a gain/loss analysis is useful in a particular situation. If this is another attempt to get at the situation with public sector plans I would point you to the required disclosures under GASB 67/68 which already require a separate line entry for the liability gain/loss versus the investment gain/loss. If the gain/loss requirement is removed from this section then the reference to such should also be removed from section 3.13 of ASOP 27 and section 3.8 of ASOP 35 as well.

Conclusion

Now is not the time to foist such a dangerous and obtrusive number into the public domain when the changes made so far to the ASOPs have barely had a chance to work. The requirement that actuaries disclose an MVL would be like pouring gasoline on a fire when the fire department (whose members are covered by a public sector pension plan) is already working valiantly to address the problem in their rational and measured way. I cannot think of a more irresponsible act for professionals to perform than to stir up conflict over what is the “right” number to use in measuring pension plan liability just when the focus of the discussion has already turned to addressing the underlying problems of disclosing and addressing risks.

Thank you for your time and attention.

Fiona E. Liston

Fiona Liston, FSA, EA

PS - I am appalled that the SOA submitted a response in favor of this idea. I’m not sure what type of deliberations lead to that letter but as a member of the SOA I assure you that I do not agree with their conclusions and question why they would even wade into such a controversy when they are ostensibly only the educational arm of the profession.

INTERNATIONAL ASSOCIATION OF FIRE FIGHTERS ®

HAROLD A. SCHAITBERGER
General President

EDWARD A. KELLY
General Secretary-Treasurer

July 23, 2018

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

Dear Members of the Actuarial Standards Board:

The International Association of Fire Fighters (IAFF) has many concerns related to the Exposure Draft of Actuarial Standards of Practice (ASOP) and respectfully submits the following comments to the Actuarial Standards Board (ASB) for the record, regarding the proposed changes to ASOP #4.

Over 300,000 professional fire fighters depend upon public sector defined benefit pension plans for retirement security. Public pension plans operate in a highly visible environment, overseen by elected governmental bodies at the state and local level and subject to scrutiny by the media and various stakeholder groups. Many of our members serve as trustees for these plans, spending their time to insure the proper management of the retirement benefits of their coworkers, and the careful use of public funds. These plans also are subject to constitutional, statutory, and case laws that create a clearly defined legal framework that governs the accrual and protection of pension benefits. We support the appropriate, meaningful, and understandable disclosure of the funded status and contribution requirements of public retirement plans so that stakeholders fully understand the nature, extent, and potential variability of the pension obligations.

For these reasons, the accuracy, clarity, and integrity of actuarial calculations and disclosures are vital to the ability of public pension plans to fulfill their legal responsibilities, and actuarial requirements and standards of practice are a matter of great relevance to us. We appreciate the opportunity to submit comments in response to the Exposure Draft of Actuarial Standards of Practice (ASOP) No. 4.

The IAFF 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 potentially misleading figure to pension reporting. The proposed Investment Risk Defeasement Measure (IRDM), similar to using a risk-free discount rate to value a benefit that in many cases is unrelated to the benefits legally required to be paid by the plan, would be most likely used as a political weapon wielded to harm the next generation of workers, including fire fighters, 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 of operatives 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 well-funded organizations such as the Arnold Foundation, ALEC, the State Policy Network and others, in an effort 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, not only is this hardly a farfetched scenario but is practically a forgone conclusion.

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 and of the ASB itself by providing fodder for those attacking the use of defined benefit plans by public sector employers.

We suggest that if the ASB insists on a requirement to calculate an IRDM, against the interests of the users of the actuarial services as well as the practitioners, that the plan actuary be allowed to describe this inclusion of information as prescribed by actuarial standards, although not necessarily providing useful information to the reader.

Our principal concerns are:

1. IRDM appears to be based on fundamental misunderstanding of public sector pension plans.
2. IRDM is even more misleading for the large, often state sponsored, risk sharing plans.
3. The most likely use of IRMD will be insuring that the work of actuaries is used to mislead other parties.
4. The ASB appears to be forcing upon public sector plan trustees – responsible for the governance of these plans – unwanted and potentially deleterious information at additional cost, both financial and reputational.
5. The proposed revisions are unusually inconsistent with actuarial principles and practices.

Comment 1 – IRDM is based on a lack of understanding of public sector plans

The ASB appears to be largely unfamiliar with the environment of public sector pension plans.

First, the problems of bankruptcy leading to the abandonment of pension plans is a private sector problem. While the PBGC has taken over more than 4,800 underfunded private sector pension plans largely due to bankruptcies and plan abandonment, the number of bankruptcies in the public sector resulting in the abandonment of pension plans can be counted on your fingers. Furthermore, states are constitutionally precluded from ever entering bankruptcy. Finally, even cities and counties rarely simply "go out of business" as people continue to live there, pay taxes and receive services. Thus, the "protection" provided by ASB's additional disclosures provides protection for nearly no one.

Second, the legal environment for public pension plans is dramatically different from private sector plans. While private sector plans are governed largely by a single statute – the Employee Retirement Income Security Act or ERISA – public sector plans are governed by state law – with 50 sets of rules governing the ability of counties and municipalities to revise pension benefits and terminate their plans. While private sector plans can always stop the accrual of benefits for both current and future employees, many state laws preclude public sector employers from stopping employees from earning the same benefit that applied when they began their employment. Thus, the ASB's apparent choice of the traditional unit credit method – excluding all future service and salaries from the considered liabilities – provides, in many cases, a counterfactual measure of the plans' liabilities.

Third, for many reasons (including but not limited to infrequency of plan terminations, infrequency of public sector bankruptcies, the nature of the pension commitments and the high cost of settlements), the settlement of liabilities through the purchase of annuity contracts or the payment of lump sums, is virtually unknown in the public sector, although we recognize that this is a frequent occurrence in the private sector.

Fourth, because virtually all public-sector employers and plan sponsors are ongoing entities, they are able to make future contributions to fund both past and future benefits. As noted above, states are legally constrained from "going out of business." The solvency of a pension plan is not based solely on the assets in the pension trust, but also by the ability of the sponsoring entities to make additional contributions to pay for both current and previously earned benefits.

Finally, while the use of insurance contracts to fund a portion of benefits was not an uncommon practice in the 1940s and 1950s, the advent of the much more efficient vehicle of the pension trust in the 1960s and 1970s, allowing for the use of equity investments to fund future pension obligations, dominates the funding of public sector pension plans. Because of the longer expected life of both the pension plans and their government sponsors, for the reasons noted above, the use of a so-called market rate (when no market exists) to price liabilities unrelated to the actual commitment of the plan sponsors, provides wholly useless information.

The National Education Association conducted a comparison of an insurance company's finances to a public pension funds to understand why a scheme to privatize annuities would provide such significantly reduced value relative to the public system that it was replacing. An 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 they are 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 ran on total expenses of only 1.3% of revenues.

These factors reflect the huge difference between a one-time transaction, such as an annuity purchase to settle pension liabilities, to an ongoing pension plan, with an active employer or plan sponsor providing future funding.

Comment 2 – IRDM Is Even More Misleading for Risk-Sharing Plans

For plans with risk-sharing or variable benefit features, it is highly likely that other funding valuation assumptions regarding variations in benefit features would be inconsistent with defeasement or with investment returns equal to yields of a bond portfolio and therefore violate Section 3.12 of ASOP 27 or Section 3.7 of ASOP 35. No guidance is provided for such situations.

The meaning and utility of the IRDM is even more ambiguous in cases of risk-sharing pension plans in which benefits are determined partly by external factors. For example, some public pension plans pay a cost-of-living adjustment that is based on the plan's funding level or on the fund's investment performance relative to some benchmark. An IRDM calculated on the basis of a Treasury bill return for a plan whose COLA is based on returns above a certain threshold, for example, would produce a particularly nebulous number. Similarly, some plans pay a COLA if investment returns exceed the plan's assumed rate of investment return. If the IRDM requires that the actuary assume an investment return of a low-risk bond rate of say, 3.0 percent, investment risk may remain but the IRDM would not represent the amount of assets needed to "defease" the investment risk as is implied by the name and stated objective in the standard. Such an outcome would reasonably be considered misleading.

Considering the large and growing number of risk-sharing elements that are embedded in public pension plan designs, we believe this to be an especially troublesome matter.

Comment 3 – IRDM Will be 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. Frequently, these recommended measures stop short of advocating that we fund pension plans using excessively low return assumptions—instead pushing only for disclosure. Moreover, funding plans in this way would cost tax dollars and that is why we strongly believe that this effort is about public relations, not economics.

We agree with the National Education Association who points to an example of some prior work by the Society of Actuaries' Blue-Ribbon Panel's co-chair, Mr. Andrew Biggs which seems relevant given that the panel's report was a stated reason for this ASB decision. Mr. Biggs also 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. Given that, he undoubtedly knows that Social Security replaces about 40% of pre-retirement income. However, when Mr. Biggs came across erroneous CBO data claiming that the program replaces 60% of income, he jumped on the opportunity to use it to advocate against improving retirement security. Within a week of the CBO's publication of this error, he wrote an article titled *"New Social Security Replacement Rate Numbers Cast Reform, Retirement Debates In Different Light,"* using the obvious error to completely mislead people about how generous Social Security benefits really are, 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.*

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.

We note that precept 8 of the Code of Professional Conduct states:

> *An Actuary who performs Actuarial Services shall take reasonable steps to ensure that such services are not used to mislead other parties. ... The Actuary should recognize the risks of misquotation, misinterpretation, or other misuse of the Actuarial Communication and should therefore take reasonable steps to present the Actuarial Communication clearly and fairly and to include, as appropriate, limitations on the distribution and utilization of the Actuarial Communication.*

We believe that the revision of ASOP 4 to included IRDM, regardless of the limitations and explanations that actuaries will put around this required disclosure, will result in extensive misuse of these disclosures and an explosion of the use of the work of actuaries to mislead other parties.

Comment 4 – Trustees are the Responsible Fiduciaries to Public Pension Plans, Not the ASB

Public sector pension plans typically have robust boards of trustees, including representatives from the employer(s), employees, retirees and tax-payers. These are the individuals with a fiduciary responsibility to the plan members – not the plan actuary or the ASB. While the plan's actuary has a responsibility to ensure that their services are not used to mislead other parties, the ultimate responsibility for the management of the plan should, and must, remain with the trustees. As previously mentioned, many of our current and former members serve as trustees for public sector pension plans, and while not actuaries, have developed relevant skills over many years and have typically been put in such positions of trust by other pension plan members.

Requiring pension plans to pay for the calculation of a value that, in many cases, is of, at most, marginal utility, is unreasonable and may violate public pension fiduciary duties.

IRDM reflects the cost of nullifying or abrogating a pension benefit. Yet public employers in many states are prohibited from leaving, or disaffiliating, from the retirement system that provides pension benefits to their employees. For public pension plans whose employers are legally obligated to pay promised benefits and to continue to provide benefits in the future, calculating an IRDM is a mere academic exercise that offers little to no practical value. As shown in results of a NASRA survey on policies governing employer disaffiliation from statewide retirement systems, public pension obligations in many instances must not only be paid, but also must be allowed to continue to accrue for plan participants who continue to work.

A requirement that a public pension plan must pay an actuary to calculate a value that is based on an event that is in contradiction of the laws governing the plan, not only is a waste of limited public pension assets, but also may require public retirement system trustees and administrators to violate their fiduciary duties, particularly the requirement that they operate solely in the interest of plan participants. Moreover, an actuary in such cases may be unable to affirm in good faith the reasonableness and consistency of actuarial calculations that include the IRDM.

Trustees will have to spend significant time and effort addressing political attacks based on IRDM.

As noted above, a mandated IRDM in a funding valuation would be interpreted as an endorsement of a measure that is frequently misrepresented as "the one true answer" of the condition and cost of a public pension plan. Such a mandate, for the mere purpose of satisfying those with an interest in this number, is neither good actuarial nor public policy. Moreover, requiring a retirement system not only to pay for such a calculation but to expend significant time and effort addressing the misuse of the information, is a misuse of public pension assets. Entities that want a settlement/MVL number have demonstrated in recent years that they can independently produce estimates of such liabilities for their purposes.

Comment 5 – Violates actuarial principals

The ASB's process in developing the IRDM proposal appears to be inconsistent with the process used for prior prosed standards. Actuarial groups, such as the Conference of Consulting Actuaries, the California Actuarial Advisory Panel, Cavanaugh Macdonald and Brian Murphy, all provide more detailed explanations of the ASB's unusual approach and decisions in developing this proposed standard. However, we feel we must note that these revisions will simply support the feeling among those who use actuaries that this standard was not developed to assist the pension clients of actuaries, but simply for political reasons – leading us to question the objectivity of all the future pronouncements of the ASB.

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.

ASOP 1 states (3.1.4):

> *The ASOPs are principles-based and do not attempt to dictate every step and decision in an actuarial assignment. Generally, ASOPs are not narrowly prescriptive and neither dictate a single approach nor mandate a particular outcome. Rather, ASOPs provide the actuary with an analytical framework for exercising professional judgment and identify factors that the actuary typically should consider when rendering a particular type of actuarial service. The ASOPs allow for the actuary to use professional judgment when selecting methods and assumptions, conducting an analysis, and reaching a conclusion, and recognize that actuaries can reasonably reach different conclusions when faced with the same facts.*

By directing the actuary to calculate an IRDM, and by prescribing how the IRDM is to be calculated, Section 3.11 of the ASOP 4 Exposure Draft conflicts directly with ASOP 1 that "ASOPs are not narrowly prescriptive and neither dictate a single approach nor mandate a particular outcome." Section 3.11 is wholly prescriptive; it leaves no room for professional judgment on the part of the actuary; and it dictates a single approach.

Public pension plans rely on professional actuaries to employ their professional training, knowledge, and judgment to fairly and accurately assess the condition and cost of the plans our members oversee. A requirement that these actuaries conduct a calculation using a prescribed formulaic process, including factors that in many cases are irrelevant to plans' legal and operating environment, contradicts both the letter and spirit of ASOP 1.

Another Exception to ASBs own 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 instead 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 people knew the idea would fail under normal circumstances. There were 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 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.

Based on previous exposure drafts and on the ASB's Procedures Manual, our understanding is that the ASB's Pension Committee typically drafts new guidance related to pension plans. Accordingly, it would have been reasonable to expect that the Pension Committee would have reviewed the responses to the ASB's July 2014 Request for Comment, and that, based on that review, the Pension Committee would have formulated and drafted any proposed changes to the ASOPs. Instead, we understand that the ASB appointed a Pension Task Force made up of just a few actuaries to review the responses. The Pension Task Force report included several "suggestions," including the IRDM disclosure requirement. The ASB then directed the Pension Committee to draft these suggestions as a new standard, in effect replacing the role of the larger and more representative Pension Committee with the smaller and less representative Pension Task Force.

As a result, the outcome of the Request for Comments, namely, to require the IRDM, was determined not by the broader consensus of the Pension Committee, but rather by the particular individuals selected for the Task Force. Moreover, at the same time the Pension Task Force was considering suggestions for changes, the ASB was also finalizing and adopting ASOP 51 regarding the identification and assessment of risk. If the IRDM requirement is indeed a risk measure and is considered to be so essential to be uniquely prescribed, we wonder why was it excluded from ASOP 51? ASOP 51 was only recently adopted and is yet to be effective.

Funding valuations subject to ASOP 51 are likely to include meaningful, relevant discussions of investment and other risks inherent in funding a pension plan. We believe it would be prudent for the ASB to observe actuarial practice under ASOP 51 prior to mandating a measurement of questionable risk-assessment value that is likely to be misrepresented by non- actuaries.

Do the ASB and SOA Simply 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.

IRDM also conflicts with the actuarial Code of Professional Conduct's requirement that actuarial communications should be clear and appropriate to the circumstances and its intended audience.

Precept 4 of the Code of Professional Conduct, promulgated by the American Academy of Actuaries, states:

> *An Actuary who issues an Actuarial Communication shall take appropriate steps to ensure that the Actuarial Communication is clear and appropriate to the circumstances and its intended audience and satisfies applicable standards of practice.*

As described above, a public pension obligation measure that is based on a discount rate using US Treasury yields or a settlement value is not, in many instances, appropriate to the circumstances and its intended audience. Likewise, as noted above, we believe that such a measure will be used to mislead stakeholders— policymakers, the media, pension plan participants, and the general public—about the condition of the pension plan. The IRDM seems to invite precisely the type of misuse that Precepts 4 and 8 are intended to avoid.

The IRDM can be expected to be used to mischaracterize the condition of public pension plans. An abundance of evidence demonstrates that a measure based on a discount rate using US Treasury yields or settlement value routinely has been cited as the "true" measure of the funding condition of public pension plans, even though many of these plans cannot legally terminate, are obligated to pay promised benefits, and are sponsored by states and other entities that are essentially perpetual. Such evidence includes published news accounts quoting adherents to financial economics who reject conventional public pension funding measures and instead assert that the actual measure of public pension plan funding is based on US Treasuries and settlement values.

In recent years, following the onset of new public-sector accounting standards and the establishment by some bond ratings agencies of proprietary methods for valuing pension obligations, multiple measurements of public pension plans have become more common and have received more attention. These metrics have led to confusion and selective use, rather than the clarity and consensus we believe is provided by using a measurement of public pension plans based on their long-term expected investment return in compliance with public sector accounting standards and longstanding practice. Requiring the actuary to calculate and communicate a defeasement liability in connection with the funding valuation will increase the number of "official" funding liability measures and will exacerbate the problems of confusion and misuse. The burden of explaining to legislators, plan sponsors and other stakeholders the purported meaning and limited usefulness of the IRDM will fall on our members-- public retirement system directors and their staff and trustees.

In addition, requiring disclosure of an IRDM, simply to satisfy those who are interested in such a number, is not good public policy. As public pension plans are subject to open meetings and open records laws, no reasonable steps are available to actuaries who perform actuarial analyses to preclude such misuse as required by Precept 8. Any disclaimers or conditions prepared by the actuary on the appropriate use of the IRDM undoubtedly will be left behind when that value is used to misrepresent the plan's funding requirements.

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 the public and the nation's fire fighters and other emergency responders of whom approximately 80% do not receive Social Security benefits from their employment.

We respectfully suggest that the ASB consider the comments articulated in this letter and issue a revised exposure draft from the Pension Committee, to eliminate a required IRDM.

We appreciate the opportunity to convey our concerns about this proposal. On behalf of 313,000 emergency responders and their families who depend on public sector defined benefit plans for retirement security, we appreciate your consideration of our views.

Sincerely,

Harold A. Schaitberger

Harold A. Schaitberger
General President

Comment #49 – 7/31-18 – 3:25 p.m.

July 30, 2018

ASOP No. 35 Revision
Actuarial Standards Board
1850 M Street, NW, Suite 300
Washington, DC 20036

Dear Former Colleagues:

I first wish to congratulate you all on your ability to modernize the wording of ASOP 35, even though it had been revised only four years earlier. As a member of the Pension Committee at the time of the latest restatement of ASOP 35, I harbor no resentment toward the current members of the Committee that they saw fit to improve upon the earlier wording.

There is one area, however, that I feel is in need of further revisiting, and I would have voiced this opinion to the Committee if I were still a member. The Committee may recall that the State of Illinois has over 650 Police and Firefighter pension plans to value. There is a propensity of the municipalities of the State to “shop” for actuaries on the basis of cost of services and the ability to reduce plan liabilities and expenses. One of these actuaries, who controlled over 200 of these municipal pension valuations, has indeed been publicly reprimanded by the ABCD.

Unfortunately, another actuary has jumped into the void created by the departure of that individual. This actuary, a Member of the Academy, has decided to make his own mortality tables for Illinois Police and a separate one for Illinois Firefighters. Not only are those sample sizes too small to yield credible results, he is using a subset of them, namely, his firm's clients, consisting of small municipalities. Because the sample size is far too small, Credibility Theory would state that there is no justification in modifying the RP-2014, much less allowing his Illinois tables to stand alone.

I attach a 2018 article for those curious enough to examine the accuracy of the previous paragraph: “Credibility Theory: An Application to Pension Mortality Assumptions” by Julie Curtis

http://pensionsectionnews.soa.org/?issueID=14&pageID=12

I would further suggest that the two members of the ASB who have been assigned to the Pension Committee consult with their Life colleagues as to how they deal with Credibility Theory.

I offer the following changes to ASOP 35 to protect against the poor practices of the above-mentioned individual. As I noted in the first paragraph of this letter, there is no pride of authorship here. I encourage the current members of the Committee to wordsmith the suggestions until exhaustion sets in:

First, add a subsection “e” to paragraph 3.5.3

3.5.3 Mortality

e. the use of relevant plan or plan sponsor experience, as sanctioned in §3.2.2, but only if one of the following two conditions are met:

i. the sample size of the group is large enough to meet the confidence level criteria of Credibility Theory

ii. the sample size of the group is large enough so that the Credibility Factor is at least 0.05.

Second, add a sentence to Paragraph 4.1.1:

4.1.1 Assumptions Used

4.1.1 The disclosure of the mortality assumption should contain sufficient detail to permit another qualified actuary to understand any Credibility Theory basis to the adjustment of the underlying table.

You will undoubtedly notice that I capitalized "Credibility Theory" and "Credibility Factor" because both are terms of art with specific meaning. Definitions of both may be found in the Julie Curtis article. I fear that using "credibility" is too much of a short cut which could open the door to abuse.

I thank you for your time. I wish you all energy and mutual respect for dealing with the review process you are embarking upon. I remember the bowl of caramel corn supplied not only instant energy but also a little sympathy to all those seemingly obstinate members who disagree.

Respectfully submitted,

Mitchell I. Serota, F.S.A., M.A.A.A.

July 30, 2018

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

Dear Former Colleagues:

I first wish to congratulate you all on your ability to modernize the wording of ASOP 4, even though it had been revised only four years earlier. As a member of the Pension Committee at the time of the latest restatement of ASOP 4, I retain no pride of authorship.

I especially wish to express my gratitude to the courage of the Committee to insert Section 3.11, Investment Risk Defeasement Measure. I would like to encourage the Committee to extend the applicability of this Section to *accounting disclosure* valuations as well as *funding* valuations. Those of us who perform disclosure valuations to comply with ASC 715 already comply with 3.11(c).

Those of us who perform disclosure valuations to comply with GASB 68 are supposed to use 20-year General Obligation bonds as a discount rate once the plan is projected to run out of money. But this requirement can easily be avoided if the plan sponsor "promises" to fund a plan in the future even when political pressures upon the plan sponsor (that is, increased taxation) impede their ability to fulfill the promise. Tightening the language of 3.11(c) will enable the end user to have a far better understanding of the liabilities of the plan in question.

I want to make sure Committee Members are aware that the bond rating agencies, who fundamentally represent the marketplace, use very safe corporate bond rates when they estimate the liabilities of a public plan from emerging outflow data. From the point of view of the profession, I believe it is best for the actuary to do the calculation correctly rather than allow a non-actuarially trained representative of a bond agency to estimate the liabilities.

In regard to the question whether the choices of the bond yields in 3.11(c) are appropriate, I would add the 20-year General Obligation bonds as a third option, just to be in harmony with GASB 68. The US Treasury yields are the classic discount rates for Financial Economic purposes, but it is absolutely permissible, in my opinion, to use very safe corporate bond yields because there is no taxation of investment return in a qualified or public plan. In non-tax-advantaged investments, the bulk of differential between US Treasurys and very safe corporate bonds is the tax.

I thank you for your time.

Respectfully submitted,

Mitchell I. Serota, F.S.A., M.A.A.A.

Department of Finance

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JOHN ADLER
Director
Chief Pension Investment Advisor

July 31, 2018

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

Dear Board Members:

On behalf of the New York City Employees' Retirement System and the Teachers' Retirement System of the City of New York, we are submitting these comments on **Section 3.11** of the exposure draft of proposed revisions to Actuarial Standard of Practice (ASOP) No. 4, *Measuring Pension Obligations and Determining Pension Plan Costs or Contributions*. These comments reflect the views of the boards of our retirement systems as a whole, but not necessarily the views of the individuals who sit on these boards or any of their respective employers.

We urge the ASB to acknowledge that the Investment Risk Defeasement Measure (IRDM) is also for all intents and purposes a termination liability or settlement measure. Requiring universal disclosure of this value has potentially far-reaching policy consequences that may have the – perhaps unintended – effect of making public pensions less secure. Calculating and disclosing the IRDM, which will potentially fluctuate significantly from year to year with changes in market interest rates, will allow critics of public pension funds to selectively pick and choose which funding measures to use in order to depict them in the worst possible light. Pension funds are long-term institutions that seek to provide their participants and beneficiaries with benefits for many decades to come, and whose sponsors (like the City of New York) have no or virtually no enterprise or solvency risk.

We believe the ASB should be championing measures that are consistent from year to year, so that actuaries can accurately calculate assets and liabilities in a way that is true to the mission and nature of these funds, which are not and should not be subject to short-term market fluctuations. Forcing actuaries to disclose the IRDM in pension fund funding reports means that the ASOP may require them to misrepresent those pension funds' funding status, in the opinion of the retained actuary. Why not *allow* the actuary to include the IRDM, thereby leaving such a reporting decision to the discretion of the actuary rather than requiring such a controversial measure to be included in funding reports? ASOP No. 4 does not require disclosure of any other specific measure of funding.

To solely mandate the IRDM even raises questions about the ASB's motivations in this endeavor. This proposed requirement could also have the unintended consequence of undermining the public reputation of the ASB as well as the actuarial profession. We urge you to modify the exposure draft of ASOP No. 4 by removing the requirement to disclose the IRDM.

Sincerely,

John Adler
Board Chair

AMERICAN ACADEMY *of* ACTUARIES

Objective. Independent. Effective.™

July 31, 2018

Actuarial Standards Board
1850 M Street, NW, Suite 300
Washington, DC 20036
Via email to comments@actuary.org

Re: Comments on Exposure Drafts of Proposed Revisions to ASOP Nos. 4, 27 and 35

Members of the Actuarial Standards Board:

The Pension Committee, Public Plans Committee and Multiemployer Plans Committee of the American Academy of Actuaries[1] (the Committees) appreciate the opportunity to present the following comments to the Actuarial Standards Board (ASB) regarding the exposure drafts of the proposed revisions to ASOP No. 4, *Measuring Pension Obligations and Determining Pension Plan Costs or Contributions*, ASOP No. 27, *Selection of Economic Assumptions for Measuring Pension Obligations*, and ASOP No. 35, *Selection of Demographic and Other Noneconomic Assumptions for Measuring Pension Obligations*. We are providing comments relevant to each specific standard, and general comments applicable to the revision of all three standards collectively. Because of the interrelated nature of these revisions, we are providing our comments in one consolidated letter rather than responding with separate letters with comments on each exposure draft.

We greatly appreciate the efforts of the ASB to develop Actuarial Standards of Practice (ASOPs) for the profession, and we believe that these exposure drafts contain some substantive improvements to the ASOPs. While we believe much good work has been done to improve these three ASOPs, we also have some concerns about certain aspects of the proposed revisions.

Before offering comments on specific sections of the exposure drafts, we have several observations regarding issues that apply across the exposure drafts that we offer for the ASB's consideration. Throughout the remainder of this letter, unless otherwise noted, references to any of the three ASOPs are to the exposure drafts. When referring to the standards as in effect as of the issuance of this letter, we will refer to the "current standard(s)."

[1] The American Academy of Actuaries is a 19,000+ member professional association whose mission is to serve the public and the U.S. actuarial profession. For more than 50 years, the Academy has assisted public policymakers on all levels by providing leadership, objective expertise, and actuarial advice on risk and financial security issues. The Academy also sets qualification, practice, and professionalism standards for actuaries in the United States.

General Comments on Proposed Revision of ASOP Nos. 4, 27, and 35

- The proposed revisions to ASOP Nos. 4, 27, and 35 may require substantial effort to implement. In addition to updating valuation processes and reports, actuaries will need to address these changes with the plan sponsors that they work with, possibly including discussions of expanded scopes of engagement. We thank the ASB for proposing a 12-month deferred effective date for these new ASOPs when finalized, since actuaries will need that time to implement any changes.

- Section 3.6.3 of ASOP No. 27 and Section 3.4 of ASOP No. 35 would permit the phase in of actuarial assumptions over a period of years, so long as the assumption in each year of the phase-in period is reasonable. While this approach does sometimes occur in practice, we are concerned that including this provision in the ASOPs might signal an endorsement of this practice. We believe is better to fully reflect assumption changes when the actuary deems those changes appropriate, and consider use of an output smoothing mechanism if needed to manage cost or contribution levels.

  If the effect of assumption changes needs to be smoothed, we believe the preferred approach would be to phase-in the effect in the outputs (i.e., the measured benefit obligations or costs), rather than the assumption inputs. The current standards already require assumptions selected by the actuary to be reasonable. It is unclear to the signatories how this change will improve actuarial practice. If the ASB decides to retain this provision, we suggest adding a requirement that the effect of full recognition of the assumption change (i.e., the benefit obligation, contribution, and/or cost using the ultimate assumption) be disclosed.

- The exposure drafts all refer to a concept that the assumption(s) selected by the actuary have "no significant bias (i.e., it is not significantly optimistic or pessimistic)." (ASOP No. 4, Sections 3.8 and 3.20(a), ASOP No. 27, Section 3.6(e), and ASOP No. 35, Sections 3.2.5(e) and 3.10.4) This requirement generally applies to both individual assumptions and the combined effect of all assumptions. We suggest that this concept be refined to provide that the assumption(s) selected by the actuary are not expected to have significant bias (i.e., it is not expected to be significantly optimistic or pessimistic). The actuary cannot know whether an assumption will turn out to be significantly biased without seeing how experience plays out and looking back at that experience versus the assumption. Therefore, we believe the ASOPs should clearly state that the actuary is only held to this standard with respect to what is expected when selecting the assumption.

- We appreciate the effort the ASB made in reviewing the wording in current ASOP Nos. 4, 27, and 35. We found that there were a significant number of subtle proposed wording changes in the exposure drafts and that it was difficult to find all of the small subtleties in the proposed changes. Therefore, we are concerned that actuaries may not notice all of the changes and suggest that a version that tracks all of the changes be posted for use by the US actuarial profession (not just potentially available upon request).

Also, it is not clear whether these subtle changes were intended to change actuarial practice, clarify the existing language, or improve the consistency of language across the various standards. In this letter, we point out some places where the ASB's intentions about future actuarial practice as a result of wording changes are not clear. However, there were many other changes that were unclear and are not mentioned in this letter. While we believe it is vital for these ASOPs to be written as clearly as possible, we ask that the ASB try to propose wording changes only when you envision a change in actuarial practice (which should be cited as a notable change in an exposure draft), when the current wording is inconsistent across the standards, or when the existing language has the potential to be substantively misleading. If changes are made solely to accomplish minor improvements in readability, clarity, or consistency, a general note to that effect in the release memorandum or an appendix summarizing key changes would be helpful.

- There was no change to the definition of "Measurement Date" in Section 2.16 of the ASOP No. 4 exposure draft. However, in Section 2.2 of the ASOP No. 27 exposure draft and Section 2.4 of the ASOP No. 35 exposure draft, the words "(sometimes referred to as the "valuation date")" were removed from the end of the definition. We think that the definition should be consistent in the three ASOPs and, if the phrase is removed from all three, we would like to understand the rationale for the change and the associated expected change in future actuarial practice, if any.

  Also, certain actuarial tasks involve the determination of pension obligations as of several dates. Consider the following examples:

  - Deterministic or stochastic forecasts involve the determination of pension obligations for a series of future dates
  - Gain/loss analysis can involve the determination of pension obligations as of several dates.
  - Back-testing to evaluate the effectiveness of alternative plan management approaches can involve the determination of pension obligations as of several past dates.

  We suggest that the standards could be improved by recognizing that actuarial tasks that involve liability calculations at multiple dates may have a single measurement date. The actuarial task may also entail the calculation of pension obligations at other dates, but the economic data or estimate of future experience as of those dates may not be appropriate to use in the determination of these obligations, and may not always be based on assumptions that meet the reasonableness requirements (for example, stress-testing scenarios in a deterministic forecast).

- We support the change to the requirement of Section 4.1.2 of ASOP Nos. 27 and 35 regarding the rationale for actuarial assumptions selected by the actuary. We appreciate the clarification from the ASB as to the intent of these provisions in the current standards and believe this is as an appropriate strengthening of actuarial practice.

Specific Comments on Proposed Revisions to ASOP No. 4

Answers to ASB's Questions

As the ASB requested, following are our responses to the questions posed in the exposure draft to ASOP No. 4:

1. *Section 3.11, Investment Risk Defeasement Measure, requires the calculation and disclosure of an investment risk defeasement measure when the actuary is performing a funding valuation. The guidance allows for discount rates to be based upon either U.S. Treasury yields or yields of fixed income debt securities that receive one of the two highest ratings given by a recognized ratings agency. Are these discount rate choices appropriate? If not, what rate choice would you suggest?*

   We believe that these discount rates would be appropriate for this purpose in many contexts, but would be inappropriate in others. Therefore, we do not believe that ASOP No. 4 should mandate any particular discount rate or rates. As discussed more fully in our comments on section 3.11 of the exposure draft, we believe that the ASB should employ a principle-based approach to defining this measurement.

2. *Under certain circumstances, section 3.20, Reasonable Actuarially Determined Contribution, requires the actuary to calculate and disclose a reasonable actuarially determined contribution. Do the conditions in this section describe an appropriate contribution allocation procedure for this purpose? If not, what changes would you suggest?*

   Generally, we agree that the conditions outlined in Section 3.20 are appropriate in defining a contribution allocation procedure for an actuarially determined contribution (ADC). In particular, we note that the requirement in Section 3.20(b) that the normal cost is based on the plan provisions applicable to each participant precludes the use of the ultimate entry age cost method.[2] We agree with this provision and support its inclusion.

   We have offered comments elsewhere in this letter regarding sections 3.13 through 3.16 which are incorporated by reference into the definition in 3.20. Those comments should be considered in the context of our response to this question.

   We also note the disclosure requirements in Section 4.1 supplement the basic requirement to disclose an ADC by imposing other disclosures on specific components of the ADC, such as the requirements in Section 4.1(x) to describe any changes in the cost allocation procedure, the reasons for the change and the general effect of making the change. This disclosure requirement is important and addresses concerns raised by members of the Committees that an actuary could change the actuarial cost method, amortization period, or other components of the contribution allocation procedure annually to produce an ADC that closely matches the actual "fixed rate" contributions found in some public

[2] Under the ultimate entry age cost method, the normal cost is based on an open tier of benefits even for members not in that tier as of the measurement date. This is not to be confused with an entry age cost method under which the normal cost is based on a member's current (but not historical) accrual rate.

sector plans.[3] For these "fixed rate" plans, the Committees believe the ADC should be determined on a consistent basis year-to-year. Requiring disclosure of any changes in the method of determining the ADC should be sufficient to achieve this consistency, while permitting the actuary to make changes when there is an appropriate reason to do so.

The Section 4.1 disclosure requirements also address the Committees' concerns about rolling amortization methods by requiring either a disclosure that the method will not fully amortize the unfunded actuarial accrued liability (Section 4.1(v)) or that the method has been changed to reset the amortization period so it does not reduce annually, and the reason for such change (Section 4.1(x)). The ASB may want to consider further strengthening the disclosure requirements by requiring that the actuary disclose if past changes to the ADC calculation follow a consistent pattern, and if so, what the implications of that pattern are.

Additional Comments on Proposed Revisions to ASOP No. 4

- Section 1.2—The third sentence of the fourth paragraph from the end of Section 1.2 (i.e., "This ASOP addresses broader measurement issues including cost allocation procedures and contribution allocation procedures, and provides guidance for coordinating and integrating all of these elements of an actuarial valuation of a pension plan.") seems to relate more to the purpose (Section 1.1) of the ASOP than the scope (Section 1.2). Also, the sentence doesn't seem critical to the purpose of the paragraph, which is to clarify which standard governs in the event of a conflict between various ASOPs. Therefore, we suggest you consider deleting this sentence since the same concepts can be found in the last two sentences of Section 1.1.

- Sections 2.5 and 2.12—The new definition of "Funding Valuation" and the definition of "Actuarial Valuation" don't refer to each other or have similar wording. In our view, a "Funding Valuation" is very closely related to an "Actuarial Valuation," and better coordination between the definitions would help actuaries understand the distinction between these two terms as they impact the ASOPs.

- Section 2.18—We believe that the proposed definition is ineffective. As written, it describes the intention of the technique (reducing the volatility of results) and lists several examples. The first sentence in the definition could be read to include *any* techniques that are intended to reduce volatility, including those that smooth inputs. We use the term "output smoothing" to describe smoothing of results, not of inputs.[4] We believe that smoothing asset values, for example, would meet the proposed definition of an output smoothing method. Additionally, the first example of "phasing in the impact of assumption changes on contributions" is unclear as to whether it is describing phasing in the change in the assumption inputs (as addressed in Sections 3.6.3 of ASOP No. 27 and 3.4 of ASOP No. 35) or using the changed assumptions and blending those results with the pre-assumption change results. We consider smoothing of assumptions or asset values

[3] In a "fixed rate" plan, the contribution rate per participant is "fixed" (often by statute) rather than driven by annual funding valuation results that would presumably be determined on a basis that would meet the definition of an ADC.
[4] American Academy of Actuaries, Issue Brief: "The Pension Protection Act: Successes, Shortcomings, and Opportunities for Improvement," April 2018.

to be input smoothing. When output smoothing is utilized, the assumptions and asset values used should be based on the actuary's observation of the estimates inherent in market data or the actuary's estimate of future experience, or a combination thereof.

The current version of ASOP No. 4 describes an output smoothing method as an approach to "adjust the *results* of a contribution allocation procedure". [Emphasis added.] Although not perfect (in part because the output smoothing method was also included as part of the contribution allocation procedure), this avoided the confusion between input and output smoothing that exists in the exposure draft. We suggest that the definition describe output smoothing as an approach to "adjust the preliminary results of the contribution allocation procedure."

Because the results of one calculation are often used in another calculation, the distinction between inputs and outputs is contextual. We suggest that the more specific term "Contribution Output Smoothing Method" be used in the ASOP. Moreover, although both the proposed and current wording in ASOP No. 4 refer to an output smoothing method only in the context of a contribution allocation procedure, similar approaches are also used to reduce volatility in other contexts. For example, an actuary may use output smoothing when allocating costs to divisions or companies within a controlled group sponsoring a plan. Using the term "Contribution Output Smoothing Method" would clarify that the actuary is not precluded from using output smoothing in contexts other than contribution allocation procedures.

- Sections 2.22 and 2.23—The wording in these sections does not exactly match the wording in Sections 2.5 and 2.6 of the ASOP No. 27 exposure draft and in Sections 2.6 and 2.7 of the ASOP No. 35 exposure draft. In the second sentence of Sections 2.22 and 2.23 of the ASOP No. 4 exposure draft, the definitions use the word "set" when "selected" is used in the other two exposure drafts. The definitions should be the same to avoid confusion and, although the defined term uses the word "set," we suggest consistent use of the word "selected" in the definitions, since that word better describes the process used and other wording in the ASOPs.

- Section 3.2(u)—The wording was changed from the current ASOP to refer to the action to "assess" instead of "evaluate," In addition, we note that both terms are used in all three of the ASOPs, but neither "assess" nor "evaluate" are defined terms in ASOP No. 1. It is unclear to us if the change was made so that there would be a change in future actuarial practice. If a change in actuarial practice is expected as a result of this wording change, it may be helpful to define "assess" and "evaluate" to help actuaries understand the distinction.

- Section 3.3—In rewording the examples of Section 3.3, one of the examples in the current standard was left off the list: "market value assessments." It is not clear why this was removed as an example. We believe this is still a reasonable purpose of a measurement that is not eliminated due to the new Investment Risk Defeasement Measure (IRDM) provisions, especially since IRDM is only applicable to funding valuations. It would be helpful to understand why the ASB decided to eliminate this as a purpose for measurement and to confirm that the ASB still believes this to be a valid purpose.

- Sections 3.4.2 and 3.5.1—The last sentence of these sections were reworded. However, when they were reworded, the fact that an actuary "may, but need not," reflect post-measurement date events was removed. Although the new wording doesn't preclude the inclusion of post-measurement date items, it is no longer clear. We believe it is important to be clear in the standard and include this option for the actuary to reflect post-measurement date events, similar to what is provided in the current standard.

Section 3.8—The current version of this section stops after the first sentence, which refers actuaries to ASOP Nos. 27 and 35. The exposure draft now has additional wording that addresses the "no significant bias" criteria with respect to the aggregate set of assumptions selected. This same language appears in Section 3.10.4 of ASOP No. 35, which cross-references to ASOP No. 27 to encompass the complete set of economic and demographic assumptions. We believe all guidance regarding the selection of actuarial assumptions should be found in ASOP Nos. 27 and 35 and not in ASOP No. 4. We suggest that Section 3.8 of ASOP No. 4 should remain as just the one sentence referring to ASOP Nos. 27 and 35 for assumption-setting guidance, and the guidance in Section 3.10.4 of ASOP No. 35 regarding consideration of the aggregate reasonability of the entire assumption set should be added to ASOP No. 27.

Section 3.11—Our comments on the IRDM fall into three categories. The first category focuses on the purpose of the measurement. The second category consists of observations regarding the potential value that could be provided by such a measure, together with the limitations it would have. The third category provides feedback on the details of how the exposure draft implements the IRDM.

Purpose of the Measurement

Before requiring a specific disclosure that may involve additional liability calculations that an actuary may not already be providing, we believe it is critical to clearly define the purpose of the disclosure and assess expectations of the value of the disclosure

The purpose of the IRDM and expectations for how it should or would be used are not fully clear in the exposure draft. The name and the description provided of "an obligation measure to reflect the cost of effectively defeasing the investment risk of the plan" implies that the purpose is related to the plan's investment risk. However, the methodology prescribed in the exposure draft appears to be intended to price a settlement for a fixed set of future payments, whether or not the pension obligation consists of a fixed set of future payments. We believe the goal of the IRDM is to provide information that improves stakeholders' understanding of the investment risk present in pension plans, and that the exposure draft should more fully explain the purpose.

Potential Value of the IRDM

The Committees believe that investment risk disclosures are critically important, and that a measurement similar to the IRDM could help address this need. For this reason, we are generally supportive of the proposed requirement. However, we also note that within the actuarial community, there are a wide range of views on whether the IRDM is the optimal way to approach this issue, or whether the recently introduced risk disclosure requirements of ASOP No. 51 provides a better framework for improving stakeholder understanding of pension investment risk. The differing views on the usefulness of the IRDM are partially attributable to differing assumptions as to the purpose of requiring disclosure of this measure, which is not clearly stated in the exposure draft. The ASB may want to consider whether it is appropriate at this time for the standards to encourage the disclosure of the IRDM, while providing actuaries with the discretion to alternatively disclose certain quantitative analyses under ASOP No. 51.

While pension plans are subject to many risks, investment risk is noteworthy for two reasons. The first is that in a majority of pension plans, it is the largest source of risk. Second, in contrast with other risks such as uncertain retirement patterns and mortality rates, plan sponsors willingly choose to bring investment risk into their plans by investing in assets other than those that best match liabilities (generally bonds with minimal default risk). Plan sponsors can also reduce this risk at any time by increasing allocations to matching assets. Plan sponsors choose to accept investment risk because they believe that the resulting returns in excess of those attainable with matching assets will be sufficient to justify the uncertainty associated with risky assets.

The IRDM has the potential to help illustrate important information about investment risk in pension plans. For example, the IRDM represents an estimate of the amount of assets that the plan would need to hold in order to protect participant benefits that are attributable to past service[5] from investment risk without any further contributions. Additionally, a comparison of the IRDM and the plan liabilities calculated using the same actuarial cost method and an expected return discount rate is a measure of the gains that the plan sponsor expects to realize due to the investment in other than matching assets.

The IRDM provides important information about investment risk in pension plans, but it also has limitations. A significant factor in the evaluation of the level of investment risk that is affordable is the ability of the plan sponsor to offset adverse experience with additional contributions, and the IRDM provides no information about the plan sponsor's ability to pay any additional contributions that may be needed. The probabilities associated with various degrees of over and under performance are similarly outside the scope of the information that the IRDM can provide. The IRDM also does not quantify the higher benefit levels that the plan promises based on expected investment returns above bond yields, nor does it address the impact that adverse investment experience that the plan sponsor is unable to offset with additional contributions could have on benefit security. We also recognize that it may be optimistic to believe that simply disclosing an

[5] As discussed later in our comments, we believe the IRDM should be defined using a principles-based approach that would permit the use of the same funding method that is used for other purposes. The portion of the present value of benefits that is attributable to past service would be determined by the funding method.

IRDM will change how the users of actuarial analyses view pension obligations and risks[6].

Despite its limitations, the calculation and disclosure of an IRDM has the potential to enhance the transparency of investment risk in pension plans. By calling attention to the difference between the cost of eliminating investment risk and the actual funding target employed by the plan sponsor, the IRDM will encourage closer examination of the level of investment risk that is present in the plan. To the extent that it does not provide all relevant information related to this risk, it may serve to stimulate additional analysis and consideration that further improve understanding. We also note that various outside parties often attempt to estimate their own IRDM-type measurements where one is not disclosed, but due to a lack of information, these estimates may be inaccurate. Having such a measurement calculated by a plan actuary could provide greater accuracy in these situations.

Implementation Concerns

While we recognize the potential value of the IRDM, we also have some concerns related to the details of how it is defined and communicated.

We recommend the adoption of a principle-based approach towards defining the IRDM in lieu of prescribing any particular discount rates or funding method. As currently defined, the IRDM specifies a specific actuarial cost method and a discount rate consistent with the yield on one of two hypothetical bond portfolios, whether or not these requirements are consistent with the purpose of the measure. This approach is contrary to the way standards have normally been set. In fact, Section 3.1.4 of ASOP No. 1 explicitly states that ASOPs are principles-based.

A better approach to providing guidance relating to an IRDM would be to clearly establish the purpose of the measurement and provide the actuary with factors to consider in selecting the assumptions and methods used to calculate the measurement. The current prescriptive approach could lead to the disclosure of meaningless or misleading results. For example, the benefit payments from hybrid benefit plans can be sensitive to changes in the economic environment (e.g., cash balance plans with variable interest credits, variable annuity plans, gain-sharing plans, plans that pay variable lump sums, and plans with variable cost-of-living adjustments). In these plans, simply discounting projected cash flows using rates derived from a yield curve may not produce a benefit obligation that provides useful information about the investment risk.

If, for example, the benefit obligation is to pay the accumulation of a notional amount assuming it is invested in the S&P 500, the minimal risk asset is not Treasuries or high quality fixed income securities, but an S&P 500 index fund. Section 3.5.3 of the current

[6] For example, it is not clear that the mandatory disclosure of current liability for multiemployer plans, and the voluntary disclosure of measures similar to the IRDM by New York City and the State of Washington, have caused the sponsors of those plans to evaluate pension investment risk differently than other plans.

ASOP No. 4 recognizes the complexities presented by benefit structures that vary based on economic conditions and requires the actuary to consider alternative valuation procedures. However, when calculating the IRDM as currently defined, it may not be permissible to consider such alternative valuation procedures without deviating from the standard. A principle-based approach to defining the IRDM would enable the standard to more effectively address the full spectrum of plan designs.[7] Care would need to be taken to ensure that such a definition effectively captures the objective of the IRDM while being flexible enough to address a wide range of designs.

In addition to prescribing two acceptable discount rate bases, the IRDM prescribes the use of the unit credit actuarial cost method. If the purpose of the measurement is related to the investment risk of the plan, it is not necessary to define the actuarial cost method to be used. In fact, requiring an actuarial cost allocation method that differs from the one used to fund the plan may inadvertently cause confusion by introducing factors unrelated to the investment risk into the analysis. Section 3.4 of ASOP No. 51, for example, indicates that one method for the assessment of risk is "a comparison of an actuarial present value using a discount rate derived from minimal-risk investments to a *corresponding* actuarial present value from the funding valuation or pricing valuation." [Emphasis added.] For a plan that uses the entry age actuarial cost method for its funding valuation, this method of assessing the risk would compare the entry age actuarial accrued liability from the funding valuation to the entry age actuarial accrued liability using a discount rate derived from minimal risk investments. It is noteworthy that ASOP No. 51 does not even suggest a comparison to a unit credit measure if such a measure is not used in the funding valuation. While this comparison does not actually assess the risks, it does estimate the cost to mitigate the investment risks, which we believe is the purpose of the IRDM.

There are numerous common measures applicable to certain types of pension plans that are already calculated and that are similar in nature to the IRDM, but it is not apparent they would meet the current definition. For example:

- Current Liability as defined in Internal Revenue Code (IRC) Section 431(c)(6)(D), which is calculated and disclosed for multiemployer pension plans, also uses accrued benefits, the traditional unit credit cost method, and the same actuarial assumptions used for funding other than discount rate and mortality table. This measure, however, uses a discount rate based on 30-year Treasury rates that would not necessarily be consistent with the rate derived from matching the Treasury yield curve with the pattern of benefits expected to be paid in the future. Additionally, it is unclear if the prescribed mortality table would be acceptable for this purpose, as it is neither used in the funding valuation nor is it based on estimates inherent in market data.

- The IRC Section 430 funding target for single-employer plans (without regard to the interest stabilization corridor) by definition meets the requirements of parts (a), (b) and (d), but it's not clear that the Section 430 segment rates meet the definition in part (c)(2), and, if they do, the use of a 24-month average adds further uncertainty that this measure would be considered an IRDM.

- The accumulated benefit obligation under Accounting Standards Codification (ASC) No. 715 determined for many single-employer plans (other than those that don't prepare US Generally Accepted Accounting Principles (GAAP) financial statements, such as many very small employers) is based on accrued benefits, the traditional unit credit cost method, and frequently a discount rate that would meet the definition of Section 3.11(c)(2). However, the actuarial assumptions used may not be the same as used in the funding valuation (e.g., mortality tables), or based on estimates inherent in market data.

A principle-based approach to defining the IRDM would provide actuaries with the discretion to decide whether any of the existing measures adequately satisfy the intent of the IRDM requirement, or whether a new liability measure must be calculated. To the extent that a readily available measure deviates only modestly from the IRDM requirement, we believe it would be reasonable to allow the actuary to use that readily available measure, along with commentary about the nature and magnitude of such deviation.

Defeasement is a term that is primarily used in the analysis of bond payment obligations, and may not effectively communicate the purpose of this measurement to pension actuaries, particularly with respect to benefit plans that incorporate hybrid or variable benefit designs. Section 3.4 of ASOP No. 51 discusses the calculation of "an actuarial present value using a discount rate derived from minimal-risk investments." This definition appears to be consistent with the purpose of the IRDM, and could more easily be applied to nontraditional plan designs. Defining the purpose of the IRDM in a similar manner to the ASOP No. 51 minimal-risk concept, while eliminating any prescriptions related to specific discount rates or actuarial cost methods, would help ensure that the purpose of the measurement is clear.

An additional potential source of confusion is the interaction between the existing ASOP No. 51 requirements related to pension risks and the proposed, new ASOP No. 4 IRDM requirement. ASOP No. 51 addresses the assessment and disclosure of risks for pension plan funding valuations, clearly defining a process by which an actuary should identify, assess, and in certain circumstances recommend to the intended user of the actuarial communication that further analysis is warranted. If the purpose of the IRDM is related to investment risk, it is confusing to include it in ASOP No. 4 instead of ASOP No. 51. This confusion is compounded by the difference between the "minimal-risk" measure referenced in Section 3.4 of ASOP No. 51 and the IRDM requirement in ASOP No. 4. The "minimal-risk" measure would likely be a different measure than the IRDM as currently defined because it would be based on the same actuarial cost method as is used for funding and might take into account plan provisions for risk-sharing that the IRDM might not. If they are intended to be different measures, it would be helpful for the ASB to provide clarity as to the intended difference.

- We also recommend modifying Section 4.1(o) of ASOP No. 4 to include as a required disclosure the purpose of the IRDM, so the users of the actuarial communication have the necessary background to evaluate the relevance and implications of the IRDM.

- Section 3.13(a)—The term "normal cost" is defined to include both the actuarial present value of projected benefits and expenses, if applicable. However, the term "normal cost for benefits" is not defined. It is not clear what this term means as expenses paid from pension plans are generally used for services that support the payment of benefits. Instead of developing a new defined term, that we expect was meant to be the defined term of normal cost without expenses, we believe it would be more clear in the first sentence of the second paragraph of (a) to adjust the wording to refer to the fact that the normal cost for a plan without benefits accruing might just be the expenses, if applicable, and not the actuarial present value of projected benefits. In addition, we believe the "and" in that sentence should be "and/or" since one of those could be true or both could be true.

  The last sentence of (a) provides for treatment of active participants who are no longer accruing benefits under a plan, and this provision is applicable through the entire standard. We agree this treatment is appropriate for the discussion of the actuarial cost method, but it may not be appropriate for other components of the contribution or cost allocation procedure. A common approach used by plan sponsors under ASC No. 715 when accounting for a frozen plan treats all of a plan's participants as inactive, even active employees who are not accruing benefits, for purposes of determining the period over which to amortize prior service costs and actuarial gains/losses. This approach is generally considered to be consistent with the guidance provided by the Financial Accounting Standards Board (FASB). The determination of the amortization period for determining plan costs is outside the scope of Section 3.13, however use of the word "standard" in this sentence would appear to make this generally accepted approach inconsistent with the guidance in ASOP No. 4. We believe the scope of this provision should be limited to this section 3.13, rather than to the entirety of ASOP No. 4.

- Section 3.13(c)—This section refers to "normal cost for benefits" as did Section 3.13(a). It is not uncommon for an actuary to reflect some forms of expenses (for example, a contract expense) in normal cost while reflecting others, such as investment costs, in the investment return assumption. Therefore, we believe it would be clearer to indicate that expenses may be reflected "as a component of normal cost and/or" as an adjustment to the investment return or discount rate assumptions.

- Section 3.14—We support the principles outlined in this section, but we are concerned that the amortization method as defined does not anticipate the use of many common amortization methods, including methods that establish a new amortization base on each measurement date and those that separate the causes of the change in unfunded actuarial accrued liability (UAAL) at a measurement date.[8]

[8] For example, a plan may measure the UAAL in year 1 and establish an amortization method that is compliant with this section. In subsequent years, the measured UAAL is compared to the unamortized balance of the base(s) established in the preceding year(s), with the difference (which may be positive or negative) established as a new

While the amortization period chosen for these methods is reasonable for the base(s) established for any given year, it is possible that the total amortization payments at a given measurement date could be greater than or less than interest on the total UAAL, violating the conditions outlined in the proposed ASOP language. To address this concern, we recommend adding an additional subsection 3.14(c) as follows:

> *If the amortization method is applied separately to changes in unfunded liability (sometimes called layered amortization) then this section can be applied separately to each layer (and not applied just to the total amortization payment compared to the total unfunded liability). The amortization period applied to layers from the same source should be at least as great for decreases as for increases (e.g., gains should have the same or longer amortization period as losses).*

We note that as worded, section (b) requiring amortization over a reasonable period of time only applies when payments do not exceed nominal interest on the UAAL. Consider an amortization method that reflects nominal interest on the UAAL plus $1. This method would not have to comply with conditions (a) and (b), but would also not fully amortize the UAAL over a reasonable period of time. We suggest restructuring this paragraph to say the payment must either exceed nominal interest on the UAAL or must not increase more rapidly than expected payroll growth, with the reasonable time period requirements currently in section (b) applying in all cases.

We also believe it would be prudent to modify Section 3.14(a) to state that payments do not increase, or do not increase more rapidly than the expected growth in plan sponsor payroll assuming no increase in the number of active employees. This language would be helpful in addressing the establishment of an appropriate method for closed plans. As currently worded, closed plans may be forced into level dollar amortization immediately upon plan closure in situations where a level percentage of payroll amortization may be an appropriate amortization method for at least some period of time.

Finally, these limitations are appropriate for a plan that is less than 100% funded to ensure that there is a reasonable plan to return to full funding. For plans in surplus, however, if Section 2.7 is interpreted to mean that a surplus is a negative unfunded actuarial accrued liability, then these limitations may force the rapid utilization of the surplus rather than reserving it as a cushion against future losses. We suggest that the ASB consider specifying that some or all of any surplus may be excluded from the amortization calculation.

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base in that subsequent year. The new base is amortized in accordance with this section, and may be further split into multiple bases that isolate actuarial gain or loss, changes in plan benefits, and assumption changes. The unamortized portion of each base is typically determined as a "write-down" of the previous year's balance at the assumed interest rate, or as the present value of the remaining scheduled amortization installments using the current year interest rate.

- Section 3.16—This section uses the adjective "reasonable" several times but does not provide any guidance on how an actuary should evaluate what might be considered reasonable. We suggest the ASB consider adding wording about factors the actuary might consider in determining what might be reasonable. The considerations in Sections 3.14(b) and 3.17 are examples of the sort of guidance that might prove helpful.

  The term "actuarially determined contribution" is defined to be the result of a "contribution allocation procedure," which is in turn defined to optionally include an output smoothing method. All instances of actuarially determined contribution that are intended to exclude the output smoothing should therefore explicitly state this. We suggest adding the phrase "without output smoothing" to references to actuarially determined contribution in items (a) and (c).

  We also suggest adding a new item (c) (and renaming the current item (c) as item (d)), worded as follows:

  > *When considering output smoothing in conjunction with the other components of the contribution allocation procedure (such as input smoothing and amortization methods), the total amount of smoothing contained in the smoothed contribution result is reasonable.*

- Section 3.17—We observe that the language in the current standard encouraging the actuary to consider "factors such as" was removed and instead a specific list that the actuary should consider is put forth. We think that the more open language should be restored, as there may be other factors that an actuary might wish to consider. We do not see the value in limiting the considerations to the factors listed.

  Removing the example of "a desire to achieve a target funding level within a specified time frame" as a relevant "input received from the principal" removes valuable guidance from the ASOP, and we suggest that it be restored.

  The items listed in (a) through (c)—benefit security, intergenerational equity, and stability or predictability of costs or contributions—are important and appropriate, and we are pleased to see them added. However, we suggest changing the listing to remove the separate listing of (a) through (c) and instead reword (d) to list a balance amongst these three items (with (a), (b), and (c) listed here) as the factor to consider. It would also be helpful to the profession to include examples of benefit security measures that might be considered, and how intergenerational equity might be reflected, as it is not feasible as an absolute measure (for example, funding unexpected mortality improvements for those participants already in pay status).

- Section 3.19—The language used in the first paragraph is confusing. In the first sentence, this section excludes funding valuations using a prescribed assumption or method set by law. But the second sentence provides that "contributions set by law" constitute a funding policy, which is part of what is to be assessed in the first sentence. It is not fully clear how contributions calculated using a prescribed assumption or method set by law differs from "contributions set by law" from the wording here. A more rigorous definition would help avoid the possibility of confusion. Note that the same language is used in Section 4.1(v)—additional clarity would be helpful in both places.

- Section 3.23—This section was not changed from the current standard and does not acknowledge the new ASOP No. 51, which requires an identification of risks that could affect the plan's future financial condition and an assessment of their effects when performing a funding valuation. Although ASOP No. 51 does not require a quantitative risk assessment, volatility is now in the scope of all funding valuations and costing valuations. Please clarify the interaction between this section and ASOP No. 51 and indicate when this section should or should not be invoked. The ASB may consider whether this section should be reworded to just refer to ASOP No. 51 instead of providing different requirements. We also note that there is no specific disclosure requirement tied to this Section 3.23, unless the disclosure in Section 4.1(dd) is meant to inform the intended user of the analysis in Section 3.23.

- Section 3.24—The first two sentences refer to language included in an actuarial communication about the party responsible for each "material" assumption and method. It is not consistent with the language in ASOP No. 27, Section 4.2 or ASOP No. 35, Section 4.2 and we think the references in ASOP Nos. 27 and 35 should be updated to be consistent. In addition, it does not seem to be in the right location within ASOP No. 4, and we suggest this concept be included in Section 4, since that outlines the communications and disclosures required.

  We also suggest that the ASB consider that it is likely sufficient that this section just reference the appropriate sections in ASOP Nos. 27 and 35 with respect to the assessment of assumptions, instead of restating or summarizing the guidance in those ASOPs. This would help avoid confusion and make sure the actuary is focusing on just one ASOP for appropriate practice when assessing assumptions.

- Section 4.1(t)—This section is part of Section 4.1(k) in the current ASOP, but the final sentence in Section 4.1(k) of the current standard (i.e., "For purposes of this section, the actuary should assume that all actuarial assumptions will be realized and actuarially determined contributions will be made when due;") is not in Section 4.1(t) (although it is found in Sections 4.1(u) and (v)). The caveat that assumptions will be realized and contributions made seems important and should apply to all of the requirements where the actuary must assess implications during future time periods. We suggest that the ASB consider placing it as a general condition that applies to all the assessments.

- Section 4.1(u)—This section requires a new determination of the period of time the actuarially determined contribution is expected to remain less than the normal cost plus interest on the unfunded actuarial accrued liability. We request the ASB clarify whether this requires a quantitative analysis or may be satisfied by a qualitative discussion. If a quantitative analysis was contemplated, we request that the ASB consider allowing the option for a qualitative analysis, based on the actuary's judgment, due to the complexity that can be involved with a complete quantitative analysis.

The ASB may also want to consider whether an alternative measure might be more appropriate, such as evaluating the actual funding policy instead of the ADC. If the plan has a fixed statutory rate, disclosing that it is never expected to exceed normal cost plus interest on the unfunded actuarial accrued liability could be powerful and might have prevented or limited some of the current underfunding situations.

- Section 4.1(aa)—It is not clear whether the "corresponding funded status" referred to in this section should be the one used in determining the ADC. Also, it is not clear what components should be used to determine the funded status—for example, would a market value of assets be more appropriate than a smoothed value? This language should be clarified to indicate which funded status should be disclosed. We suggest adding something like the following to the end of this section:

  using the measure of plan assets and actuarial accrued liability used in the actuarially determined contribution

Specific Comments on Proposed Revisions to ASOP No. 27

- Sections 1.2 and 4.2—The ASB reworded the following sentence in Section 1.2: "The standard also applies whenever the actuary has an obligation to assess the reasonableness of an economic assumption that the actuary has not selected." Previously the sentence referred to "prescribed assumptions," which refers to defined terms in Sections 2.5 (those set by another party) and 2.6 (those set by law). The reference to "prescribed assumptions" was clear in the original language. While the new wording is not unclear, the change raises a question as to whether there is an intended change in practice. If no such change is anticipated, we recommend restoring the original reference to "prescribed assumption." A similar change in language was made in Section 4.2, and the same comment applies there.

- Section 3.1 (and elsewhere)—We observe that the term "evaluate" found in the current version of the ASOP has been changed to "assess." Please see our comments above on this change in Section 3.2(u) of ASOP No. 4.

- Sections 3.5.2 and 3.5.3—The phrase "the actuary should consider" has been replaced by "the actuary should take into account". "Should consider" is defined in ASOP No. 1. "Should take into account" is not. This is also found in Section 3.5.3 of ASOP No. 35. If the phrase "should take into account" is intended to convey different guidance to the actuary than "should consider," then for clarity we recommend the ASB highlight the intended change in the summary of key changes when the final ASOP is issued.

- Section 3.6 –The first sentence of this section is awkward and appears to have no difference in meaning from the comparable sentence in Section 3.6 in the current version of ASOP No. 27. Please consider restoring the current language, or modifying it for clarity if intended to change current practice.

- Section 3.12—We observe the elimination of what had been the last paragraph of this section: "Assumption selected by the actuary need not be consistent with prescribed assumptions…." Although this can be inferred from other passages of the section, this explicit statement is helpful clarification. We suggest that this sentence be restored.

- Section 4.1.2—This section is clear regarding the disclosure requirements regarding the rationale for i) significant assumptions selected by the actuary and ii) assumptions selected by another party that the actuary determines to be reasonable. Please consider adding an explicit statement that this section does not apply to an assumption the actuary has not selected and made no determination of whether it is reasonable, as discussed in Sections 3.14 and 4.2 of ASOP No. 27 and ASOP Nos. 4, 6, and 41.

- Section 4.2—The guidance found in (a) and (b) each refers to Section 3.13. We believe that these references should be updated to 3.14, Assumptions Not Selected by the Actuary.

- Appendix 2—The exposure draft did not make any changes to the discussion in Appendix 3 of the current ASOP (referred to as "Appendix 2" herein) on the use of forward-looking expected arithmetic versus geometric returns as a discount rate. An Academy Practice Note that has been released as an exposure draft discusses this issue more fully. One of the important concepts from Appendix 2 that is discussed more fully in this Practice Note is that these approaches differ in focus between expected value outcomes versus median outcomes. We believe that Appendix 2 should include additional discussion of the possible consequences of these approaches related to their expected outcomes, as described in the practice note.

Specific Comments on Proposed Revisions to ASOP No. 35

- Sections 1.2 and 4.2—Please see our comments regarding these same sections in the ASOP No. 27 exposure draft.

- Section 3.2.4—The language in this section has been modified to include the statement "In addition, the actuary should not give undue weight to experience that is not relevant." While we agree irrelevant experience should not be given undue weight, we question whether it should be given any weight at all. We suggest changing the wording to something similar to the following:

  In addition, the actuary should give weight to experience that is appropriate to its relevancy to future expectations.

- Section 3.2.5—The first sentence of this section is awkward and appears to have no difference in meaning from the comparable sentence in Section 3.3.5 in the current version of ASOP No. 35. Please consider restoring the current language, or modifying it for clarity if meant to change current practice.

- Section 3.6.2—In contrast with the current version of ASOP No. 35, the language in the exposure draft is not clear in saying the actuary may need to select a marriage assumption. The language in the current ASOP No. 35 is clear and concise, and is substantively the same as the proposed language in the exposure draft. Please consider modifying the language to clarify that a marriage assumption—in addition to an assumption regarding beneficiary ages—may be necessary.

- Section 3.7—We observe the elimination of what is the last paragraph of this section in the current version of ASOP No. 35: "Assumption selected by the actuary need not be consistent with prescribed assumptions…." Although this can be inferred from other passages of the section, this explicit statement is helpful clarification. We suggest that this sentence be restored.

- Section 3.10.4—This section provides that the actuary should select assumptions "such that the combined effect of the assumptions has no significant bias…except when provision for adverse deviations are included." Unlike the current version of ASOP No. 35, it is unclear whether this "no significant bias" requirement applies solely to the combined effect of assumptions selected by the actuary or to all assumptions (including the effect of individual prescribed assumptions combined with those selected by the actuary). We believe the intent is the former and request that section is reworded to be similar to Section 3.8 of the ASOP No. 4 exposure draft, which provides that "the combined effect of the assumptions selected by the actuary has no significant bias…."

- Section 4.1.2—This section is clear regarding the disclosure requirements applicable to the rationale for i) significant assumptions selected by the actuary and ii) assumptions selected by another party that the actuary determines to be reasonable. Please consider adding an explicit statement that this section does not apply to an assumption the actuary has not selected and made no determination of whether it is reasonable, as discussed in Sections 3.9 and 4.2 of ASOP No. 35 and ASOP Nos. 4, 6, and 41.

****

We appreciate the ASB giving consideration to these comments. Please contact Monica Konate, the Academy's pension policy analyst (konate@actuary.org; 202-223-7868), if you have any questions.

Respectfully submitted,

Ellen L. Kleinstuber, MAAA, FSA, FCA, FSPA, EA
Chairperson, Pension Committee
American Academy of Actuaries

Thomas B. Lowman, MAAA, FSA, FCA, EA
Chairperson, Public Plan Committee
American Academy of Actuaries

Jason Russell, MAAA, FSA, EA

Chairperson, Multiemployer Plan Committee
American Academy of Actuaries

OPERS

Ohio Public Employees Retirement System

July 31, 2018

Actuarial Standards Board
1850 M Street, NW, Suite 300
Washington, DC 20036

Dear Actuarial Standards Board Members:

Founded in 1935, the Ohio Public Employees Retirement System (OPERS) is a public pension fund based in Columbus, Ohio. With assets of nearly $102 billion, OPERS is the largest state pension fund in Ohio and the 12th largest public retirement system in the United States. OPERS is a long-term institutional investor with holdings in more than 9,300 companies.

As a state public pension system, OPERS is pleased to have the opportunity to respond to the 2018 Proposed Revision of Actuarial Standard of Practice (ASOP) No. 4., *Measuring Pension Obligations and Determining Pension Plan Costs or Contributions*.

Overall Comments

We thank the Actuarial Standards Board (ASB) for considering public comments to this proposed draft. We support the ASB's effort to update ASOP 4 to reflect the current environment and emerging actuarial practices. The majority of changes proposed in this ASOP revision will no doubt enhance the reporting and management of pension obligations. We have two specific areas for which our comments are focused. Our specific responses to these two sections are set forth below.

<u>Section 3.11, Investment Risk Defeasement Measure (IRDM)</u>:

We have serious concerns with the requirement that the actuary calculate and disclose an obligation measure to reflect the cost of effectively defeasing the investment risk of the plan when performing a funding valuation. For state public pension systems, the funding valuations are performed to determine the systems' funding progress against long-term funding benchmarks and calculate the actuarially determined contribution. For OPERS, our contributions are determined by statute and, therefore, the funding valuation is also used to determine the adequacy of these rates.

As such, the funding liability is and should be measured using actuarial cost methods and assumptions appropriate for ongoing public pensions. The unit credit cost method is rarely used for public pensions, is not a good measure of funding and does not reflect future service accruals or salary increases. This cost method is not permitted by the Governmental Accounting Standards Board. Also, it is unclear what demographic assumptions would be used in conjunction with the prescribed projection methodology. It appears there would be a unique set of assumptions

OPERS

developed for use with the IRDM, which are not necessarily based on the System's experience. Finally, the prescribed rate of return does not reflect the ongoing and long-term nature of the plans.

If the goal truly is to assess the investment risk, the required parameters already exist within the actuary's work to assess and share that information with the sponsoring system. The development of liability under the prescriptive requirements of the IRDM seems to do a disservice to systems by requiring rigidity for the sake of purported comparability. If additional quantification of investment risk is needed, it may be more appropriate to include it in ASOP 51; however, we would strongly advocate for greater actuary discretion rather than a more prescriptive approach and a flawed measure.

Not only is this measure not useful to systems, an alternative liability measure could potentially confuse key stakeholders and be misused when determining funding needs. Already, the notion of an alternative liability measure has led to questions regarding the appropriateness of the funding liability and whether assets far in excess of full funding should be targeted. Requiring a defeasement liability in connection with the funding valuation will only exacerbate this problem. There will now be two "official" funding liability measures, both based on the actuary's calculation.

Sufficient data already exists for alternative calculations by either the System or other entities. For example, the bond rating agencies are currently recalculating the liability based on their own criteria, each of which varies by bond rating agency. However, even the bond rating agencies are using discretion in their calculation, communication and reliance on their alternative measures. Currently, OPERS communicates quarterly with each bond rating agency to help in their evaluation of the pension liability on behalf of our 3,700 participating employers.

Two key guiding principles of most public pension systems are: 1) intergenerational equity, and 2) contribution stability. The volatility associated with the defeasement liability could result in inappropriate conclusions and pressure resulting in poor decisions. Systems such as OPERS focus on long-term realistic progress to minimize significant shifts. Inclusion of the IRDM in funding discussions could result in significant changes in benefits in response to the investment market volatility. The result will be significant intergenerational inequity between participant cohorts in the form of unequal contributions and benefits.

Our interpretation of the prescriptive nature of the requirements of the IRDM calculation is to facilitate comparisons between systems. Otherwise, we believe the ASOP would have permitted the actuary discretion in the calculation. However, we believe this will lead to undue reliance on a flawed measure. The assessment of the plan's investment risk is cited as one of the primary reasons for the calculation of the defeasement liability based on a discount rate that reflects much lower investment risk. However, a comparison of the "traditional" funding liability against the defeasement liability doesn't necessarily provide additional understanding or comparison of the underlying risk. For example, if a plan is 100% funded on a traditional funding liability basis, but only 70% funded on a defeasement liability basis, one might ask if it is at risk. Similarly, a plan that is funded at 90% and

OPERS

60%, respectively? Future contributions expected into the plan are not a consideration in the assessment. This could be helpful for a system considering termination, however with rare exception systems are ongoing. We believe a more appropriate analysis of the investment risk could be evaluated using deterministic scenario analysis, which is widely used and understood by public pension plans to assess risk. Many public pension plans, including OPERS, regularly perform stochastic simulations of their plans to determine the probabilities of experiencing various adverse outcomes. These types of risk assessment techniques consider future funding of the plan and do a much better job of assessing risk prospectively and informing the stakeholders of such risk.

Lastly, the calculation and disclosure of a defeasement liability as part of the funding valuation cycle increases annual costs for public pension systems. Although the additional cost may be minimal relative to a system like OPERS, it may not be minimal for other systems. More importantly, it is a cost that provides no value to OPERS and its members. These are precisely the types of costs we actively search for and remove to benefit the system and our members. Just as removing many inefficiencies can lead to material savings, imposing many unnecessary requirements will lead to material losses.

<u>Section 3.20, Reasonable Actuarially Determined Contribution</u>: Although OPERS' contributions are fixed rates prescribed by law, we annually disclose an Actuarially Determined Contribution (ADC). Our ADC determination satisfies the conditions outlined in the ASOP.

Thank you for this opportunity to express our opinions regarding the proposed revision of ASOP 4. Please contact us if you have any questions or would like to discuss our comments.

Sincerely,

Karen Carraher

Karen Carraher
Executive Director

Craig Hallermann

Craig Hallermann, FSA, MAAA, FCA
Actuary

July 31, 2018
Sent via e-mail to comments@actuary.org

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

Subject Proposed Revision of Actuarial Standard of Practice (ASOP) No. 4

To Members of the Actuarial Standard Board (ASB):

We appreciate the opportunity to comment. This letter documents the response of Principal Financial Group Retirement Actuarial Services to the proposed revision of Actuarial Standard of Practice ("ASOP") No. 4 Measuring Pension Obligations and Determining Pension Plan Costs and Contributions, as requested in the Exposure Draft (ED) of March 2018.

Principal provides actuarial services and consulting to over 500 defined benefit plans based in the United States. Our Retirement Actuarial Services group is comprised of approximately 25 credentialed actuaries subject to the Actuarial Standards of Practice. This letter was prepared by the author in conjunction with thoughts and opinions from other actuaries within Principal.

Section 3.8, Actuarial Assumptions*, was expanded to provide additional guidance regarding the selection of assumptions.*

We generally agree with this section and the cross references to ASOP 27 and ASOP 35. Regarding "adverse deviation", we suggest a cross reference to the Setting Assumption Exposure Draft (released December 2016). It is not clear what adverse deviation means under the current ASOP 4 exposure draft.

Section 3.11*,* ***Investment Risk Defeasement Measure****, requires the calculation and disclosure of an investment risk defeasement measure when the actuary is performing a funding valuation. The guidance allows for discount rates to be based upon either U.S. Treasury yields or yields of fixed income debt securities that receive one of the two highest ratings given by a recognized ratings agency. Are these discount rate choices appropriate? If not, what rate choice would you suggest?*

As stated from Section 3.1.4 of ASOP 1:

"The ASOPs are principles-based and do not attempt to dictate every step and decision in an actuarial assignment. Generally, ASOPs are not narrowly prescriptive and neither dictate a single approach nor mandate a particular outcome. Rather, ASOPs provide the actuary with an analytical framework for exercising professional judgment, and identify factors that the actuary typically should consider when rendering a particular type of actuarial service."

We request that the ASB provide an explanation of how this section complies with ASOP 1. We agree that there are certain circumstances where disclosing the investment risk of the plan is both useful and appropriate, however, the measure may not be applicable for all funding valuations. We recommend referencing ASOP 51 (Assessment and Disclosure of Risk Associated with Measuring Pension Obligations and Determining Pension Plan Contributions).

In Section 3.11, the current ED states, “the actuary should calculate and disclose” and lists the detailed assumptions used for the investment risk defeasement measure. The use of the word “should” implies “normal and appropriate practice for an actuary to follow”. For many of our clients, this exercise could prove to be a burden that may not result in any meaningful benefit to them. We recommend changing “should” to “may”.

U.S. private corporate pension plans are already subject to various funding and accounting rules with multiple sets of interest rates. We request that the ASB allow ERISA private pension plans to use an existing funding liability with current spot rates or an accounting liability with market rates to satisfy this proposed investment risk defeasement measure.

The ASOPs allow for the actuary to use professional judgment when selecting methods and assumptions, conducting analysis, and reaching conclusions. When faced with the same information, it’s reasonable that different actuaries could reach different conclusions. We strongly request that the ASB reconsider section 3.11.

We thank the ASB for the opportunity to comment on the exposure draft. Please contact us directly if you would like to discuss.

Sincerely,

Yubo Qiu, FSA, EA, CFA, FCA, MAAA
Consulting Actuary
Retirement Actuarial Services
Principal(SM)

PUBLIC PENSION FINANCIAL FORUM

Public Pension Financial Forum
c/o Ohio Public Employees Retirement System

277 E. Town Street

Columbus, OH 43215

July 31, 2018

Actuarial Standards Board
1850 M Street, NW, Suite 300
Washington, DC 20036

Dear Board and Staff:

The Public Pension Financial Forum (P2F2) is pleased to have the opportunity to respond to the 2018 Proposed Revision of Actuarial Standard of Practice (ASOP) No. 4, *Measuring Pension Obligations and Determining Pension Plan Costs or Contributions*.

P2F2 was formed in 2004. The purpose of this organization is to promote excellence in public pension plan financial operations, provide educational programs of current interest to the membership, promote the exchange of ideas concerning financial operations and reporting between public pension plans, and to foster sound principles, procedures and practices in the field of public pensions related to the financial operations of such plans. Membership is open to any finance employee of a public pension who supports the purposes of P2F2. The organization currently has 325 members representing 130 employee benefit plans, offering defined benefit, defined contribution and hybrid plans.

We would like to thank the Actuarial Standards Board (ASB) for considering public comments to this proposed revision and believe public comments are an integral part of the process to determine standards and related authoritative guidance. Attached are comments to the proposed revision of ASOP No. 4 that are of interest to our membership for your consideration.

First we would like to commend the ASB for the work that has gone into the revisions included in the ASOP No. 4 Exposure Draft regarding Sections 3.14 through 3.21, and Sections 4.1 through 4.2. We note that additional detail could be included in Section 3.14, *Amortization Method*, regarding the acceptance of a layered amortization approach and perhaps inclusion of guidance regarding amortization of a surplus, as opposed to only addressing the amortization of an unfunded actuarial accrued liability. Other than those two general comments, we will defer to the actuarial firms and organizations, as well as individual public pension plans/systems to address the more detailed aspects of these sections.

The majority of our dissenting comments focus on Section 3.11, *Investment Risk Defeasement Measure*, (or "IRDM") included in the ASOP No. 4 Exposure Draft and our belief that this proposed "measure of investment risk" is basically flawed in concept, calculation, and application as currently described in the Exposure Draft. Below we present our assessment of the risks related to the IRDM **as viewed by the public pension plans** that depend upon actuarial expertise and judgement for annual valuation and disclosure purposes. We intend our comments to bring to light specific risks that arise from the requirement of this measurement; risks such as:

- Reasonable assumptions and methods,
- Defendable disclosures,
- Legal interpretations, and
- Actuarial reputation.

Reasonable Assumptions & Methods Risk

Inappropriate Actuarial Cost Method

There are certain actuarial cost methods that generally are considered inappropriate for the public sector retirement plans. One of these methods is the unit credit cost method, which is prescribed for purposes of determining the proposed IRDM metric within the ASOP No. 4 Exposure Draft. As evidence to our statement, **this cost method is rarely used for public pension plans regarding funding valuations and is not allowed by GASB** for use in valuations for accounting and financial disclosure purposes.

Inappropriate Demographic Assumptions

Many of the demographic assumptions used in the funding valuation for active participants, such as future retirement rates, are not reasonable for use in a valuation of a plan that does not recognize future eligibility and benefit service accruals or future pay increases. Members who no longer earn future service credits or pay increases behave much differently. Although Section 3.11 allows for use of the same non-economic assumptions as those applied in a plan's funding valuation, **using assumptions intended for an "ongoing" plan in the determination of the IRDM would not be appropriate**. A unique set of assumptions would need to be developed for the determination of the IRDM.

Unrealistic Discount Rate

Unlike private sector plans, pension plans that serve public entities and thus, large populations of public employees, are typically considered ongoing entities as are the governments they benefit. Therefore it only would be appropriate to value the liabilities of these **public pension plans reflecting an ongoing and long-term perspective**. With respect to public sector pension plans, the P2F2 Board believes the limited choices of discount rates as prescribed by Section 3.11 of the ASOP No. 4 Exposure Draft, are too narrowly defined, reflect only a market-value or settlement rate, and are not representative of a discount rate that would accurately value funding liabilities of an on-going plan. Additionally, the prescribed discount rate introduces material volatility in the IRDM on an annual basis that is unrelated to improvements or setbacks in a plan's actual funded health. Rating agencies that calculate alternative values based on a market indexed rate have expressed the need to "filter" out this impact when assessing annual changes in value or making comparisons between plans with different measurement dates. We believe this discount rate volatility also would be an issue for any user of the IRDM.

Purpose of the Measurement

A primary consideration in the selection of actuarial methods and assumptions, as emphasized in ASOP Nos. 4, 27 and 35, should reflect the "purpose of the measurement". The IRDM, as delineated in the ASOP No. 4 Exposure Draft, is described as an investment-risk measure. However, as noted above, the assumptions and cost method mandated for use in the calculation of the IRDM do not produce a number that is useful in measuring ongoing investment risk. Its only reasonable use or purpose is as an estimate of the cost of settling the obligation regarding accrued benefits of the plan. Therefore, the P2F2 Board **does not believe the purpose of the measurement, as stated, is being met**, but rather the IRDM is a metric of the cost of avoiding "investment risk", and not a true assessment of "investment risk". We do not believe the proposed IRDM would add value for the users of our funding valuation or contribute pertinent information upon which to base long-term funding decisions. The inclusion of this metric in the final version of ASOP No. 4 would simply be an expensive requirement with no real value to the users.

Defendable Disclosure Risk

Challenges of Explaining Two "Right" Numbers

If the ASOP No. 4 Exposure Draft is adopted as written, given the mandated nature of the IRDM, the P2F2 Board is very concerned there will be **confusion as to which pension liability value is accurate**. Additionally, the issuance of the new pension liability likely would be misinterpreted as a recommendation of the actuary despite any disclosure to the contrary. We believe this approach will unnecessarily cause confusion and misunderstanding among the memberships, employers, legislators, and tax-payers who embody the stakeholders of all public pension plans.

Narrow Viewpoint

The IRDM, as suggested by its name, mainly focuses on investment risk. If the IRDM is truly a measure of risk that should be taken seriously by all pension plans, it **should reflect and/or test other aspects of risk**, such as unexpected fluctuations in plan funding, recognized longevity improvements, variations in salary scale, and unanticipated plan experience related to retirements, terminations, and/or disabilities. The IRDM also should reflect the expected exposure to investment return volatility inherent in a plan's actual fund portfolio, not be restricted to the use of an arbitrarily prescribed rate of return that has no relationship to the portfolio. The P2F2 Board views the IRDM approach as too narrow-minded and believes a more broad-based approach has been sufficiently reflected in the risk assessments suggested in ASOP No. 51, *Assessment and Disclosure of Risk Associated with Measuring Pension Obligations and Determining Pension Plan Contributions.*

Bond Rating Agencies

We understand that there are bond rating agencies and perhaps financial economist that may find a settlement, or "market value", metric, such as the IRDM, useful; however, many bond rating entities currently determine their own alternative values. Based on our understanding, their estimated values use methods and assumptions that vary from those prescribed in proposed ASOP 4. Therefore, we believe it is likely that one type of "user" of the IRDM information would simply ignore the metric and **use the calculations determined by their own organization applying their own methods and assumptions**. This would deem the determination of an IRDM practically useless and the confusion it likely will cause among other readers of the actuarial funding valuations (all public plan stakeholders), pointless and unnecessary.

Legal Interpretation Risk

The Legalities of Settlement

Identifying the IRDM as a "settlement measure" may, in effect, limit its relevance within the public pension plan sector. As generally noted in a number of court cases across the United States, it is **illegal for most public pension plans to freeze benefit accruals or to settle obligations**. The presentation of such a metric in actuarial reports may increase the risk of misuse and/or misinterpretation by implying potential for, most commonly, an impermissible action.

Actuarial Reputation Risk

The ASOP Approval Process

The P2F2 Board would like to comment on the apparent and **intended deviation from well-established ASB procedures**. Within the characteristic process of the review and revision of an ASOP, the ASB's Pension Committee typically would review and draft any new guidance related to pensions. This step was noted in the review of the current ASOP No. 4, within the 2011 – 2013 review and adoption/revision process. However, following the ASB's July 2014 *Request for Comment* regarding public sector actuarial practices, the ASB opted, instead, to form a smaller Pension Task Force to review the responses and make suggestions. Although the formation of a task force is an acceptable (but not often employed) practice, the ASB substantially adopted the Pension Task Force suggestions for inclusion in the ASOP No. 4 Exposure Draft. P2F2 questions the ASB's reasoning for deviation from an otherwise well-established process.

Recently Revised ASOP No. 4

Perhaps more important than the deviation from typical procedures as described above; was the **notable revisiting of the review of ASOP No. 4**. The more traditional review of ASOP No. 4 which took place between January 2011 and December 2013 apparently was discounted as insufficient given the commencement of the latest process of review which commenced almost as soon as the revised ASOP No. 4 was adopted.

Recently Adopted ASOP No. 51

ASOP No. 51, "*Assessment and Disclosure of Risk Associated with Measuring Pension Obligations and Determining Pension Plan Contributions*", was recently adopted as of September 2017. In the general opinion of the P2F2 Board, **a more appropriate measure of investment risk** can be found in Section 3.4 of this ASOP No. 51, which states,

> "Methods may include, but are not limited to scenario tests, sensitivity tests, stochastic modeling, stress tests, and a comparison of an actuarial present value using a discount rate derived from minimal-risk investments to a corresponding actuarial present value from the funding valuation or pricing valuation".

If the IRDM is such a necessary measurement of investment risk to drive the inclusion of its determination in ASOP No.4, then why was it not included in the more appropriate ASOP No. 51, which has the words "*Assessment and Disclosure of Risk Associated with Measuring Pension Obligations*" in its title, rather than an ASOP focused on measuring pension obligations for funding purposes?

ASOPs, Generally Non-Prescriptive

As promulgated by ASOP No.1, the **ASOPs are intended to be principle-based, and not prescriptive**. As specifically stated in ASOP No. 1, Section 3.1.4,

> "Generally, ASOPs are not narrowly prescriptive and neither dictate a single approach nor mandate a particular outcome. Rather, ASOPs provide the actuary with an analytical framework for exercising professional judgment, and identify factors that the actuary typically should consider when rendering a particular type of actuarial service. The ASOPs allow for the actuary to use professional judgment when selecting methods and assumptions, conducting an analysis, and reaching a conclusion, and recognize that actuaries can reasonably reach different conclusions when faced with the same facts."

This ideal does not appear to be reflected in Section 3.11 of the AOSP No. 4 Exposure Draft, as the description of the determination of the IRDM is quite prescriptive.

IRDM in Conflict with Precept No. 4 and No. 8

Implying the IRDM, as currently described in the ASOP No. 4 Exposure Draft, is to be determined as a "settlement measure", the presentation of such a metric in actuarial reports may invite misuse and/or misinterpretation by others. This could create a significant liability for actuaries signing such reports in terms of their **responsibilities detailed under Precept Nos. 4 and 8 of the *Code of Professional Conduct***. These Precepts state that the actuary in question must take reasonable steps to ensure their actuarial communications are clearly appropriate to the circumstances and their intended audience and satisfy applicable standards of practice (Precept No. 4) and also to ensure that their services are not used to mislead other parties (Precept No. 8).

The notable change in ASOP procedures, regarding the development of the Exposure Draft, alone may be enough to drive doubt into the process by which ASOPs are developed and updated. Considering the five items presented above, the adoption of the Exposure Draft as currently proposed could be viewed by those who depend upon input from the actuarial profession as a solid basis for diminished confidence in and credibility of the ASB, the ASOPs, and the actuarial profession in general, thereby inciting actuarial reputational risk.

Conclusions

In the world of public pension plans, governing boards and system staff struggle each day with education of and communications to our stakeholders. We are constantly working toward the defined goals of ensuring transparency and accountability while promoting contribution rate stability and intergenerational equity. In the collective opinion of the P2F2 Board, the seemingly urgent need for yet another liability measurement, a settlement measurement, that is determined through the prescribed use of an actuarial cost method generally considered inappropriate for public pension plans, in concert with the use of a non-applicable discount rate for an ongoing entity, is a distinct culmination of risk on every level. We are speaking to the risk of misinterpretation and misuse, inaccurate and inappropriate calculations, impermissible or illegal determinations, and reputational risk, particularly for those providing actuarial expertise and judgement in the production of annual funding valuations and disclosure information for public pension plans.

As pointed out above, there are a few items included in the ASOP No. 4 Exposure Draft that we find appropriate with the exception of Section 3.11, regarding the required calculation and disclosure of an IRDM. However, the P2F2 organization would encourage a more thoroughly researched and appropriately vetted approach in the determination of revisions ultimately to be included in ASOP No. 4.

Again, we appreciate the opportunity to comment on this project. Should you have any additional questions regarding these comments, please feel free to contact our organization by emailing Karen Carraher at kcarraher@opers.org.

This response was prepared by a collective effort of the P2F2 Board. By our e-mail submission, the P2F2 Board of Directors substantially agrees with the views in the form presented in this response. However, there are some areas where one or more P2F2 directors may have a slightly different perspective which will be shared with the Actuarial Standards Board in their systems' separate responses to the proposed revision.

Sincerely,

Karl Greve

P2F2 President

ASOP No. 4 Revision July 31, 2018
Actuarial Standards Board
1850 M Street, NW, Suite 300
Washington, DC 20036

Re: Comments on ASOP4 Exposure Draft

Dear Members of the Actuarial Standards Board,

Thank you for the opportunity to comment on the Proposed Revision to Actuarial Standard of Practice (ASOP) No. 4 ("ASOP4"). The Retirement Security Initiative (RSI) is a national, bipartisan advocacy organization focused on protecting and ensuring the fairness and solvency of public sector retirement plans. Our mission is to inform and educate policy leaders and the public regarding the importance of fair and sustainable public sector retirement plans and organize and support policy development and advocacy efforts at the federal, state and local levels.

In our efforts to inform and educate policy leaders and the public about pension issues and explore policy options, we rely heavily on publicly accessible pension plan data – particularly actuarial valuation reports and CAFRs. Using valuation reports can be difficult, particularly when trying to compare plans, due to the extreme variations in assumptions used to create the valuations.

We see the proposed changes as providing much needed sunshine on the health of pension plans, especially when trying to do side-by-side analysis. This transparency is desperately needed to inform plan members and the general public.

Also important is the provision that would require a plan's actuary to explicitly opine on the reasonableness of assumptions set by a plan sponsor. We have observed actuaries discuss with retirement board trustees, often passionately, about the need to use prudent assumptions, but have rarely – if ever – read discussions of the reasonableness of these assumptions in the final valuation reports. This requirement would go a long way in providing positive pressure for sound decision making by pension board trustees.

Thank you again for the opportunity to submit comments in support of changes to ASOP4. Please do not hesitate to reach out if additional information would be useful. As an organization whose founding principles include the expectation that the decision making and management of retirement plans should be open, transparent and non-political, we write today in support of the proposed changes to ASOP4

Sincerely,

Pete Constant, CEO
Retirement Security Initiative

BARTEL ASSOCIATES, LLC

July 31, 2018

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

Re: Proposed Revisions of ASOP No. 4

Dear Actuarial Standards Board:

This letter provides comments on the Exposure Draft of the Proposed Revision of Actuarial Standard of Practice No. 4 – Measuring Pension Obligations and Determining Pension Plan Costs or Contributions.

Bartel Associates, LLC is an actuarial consulting firm specializing in providing public sector actuarial consulting, including pension plan and retiree medical valuations.

Some of the comments provided in this letter are derived from this general philosophy.

Section 3.11 Investment Risk Defeasement Measure (IRDM):

1. Is in direct conflict with ASOP 1 3.1.4 and would move actuarial standards away from being principles based towards being prescriptive. In general, we believe ASOPs should continue to be principles based and if the ASB disagrees then there should be discussion within the actuarial community on this very issue rather than just making one change to one ASOP.
2. Requires an actuary calculate and disclose, in some instances, results that have no value to any user of the valuation.
3. Would be in direct conflict with Precept 8 of the Actuarial Code of Professional Conduct: "An Actuary who performs Actuarial Services shall take reasonable steps to ensure that such services are not used to mislead other parties."
4. Adds unnecessary cost to a pension valuation.
5. Will almost certainly cause IRDM results to be confused with funding results. As currently defined, the IRDM is not an appropriate measure for communicating the stated purpose of the measure – i.e. measuring the cost to defease the investment risk for a pension plan.

For the above reasons, we recommend the ASB rescind the IRDM disclosure requirement and allow practice to develop under the "purpose of measurement" guidance of ASOP Nos. 4 and 27 and the risk assessment guidance of ASOP No. 51.

Section 3.14 Amortization Method. We recommend, for those plans that use layered amortization, the conditions of Section 3.14 could apply either to each amortization base or layer individually, or to the aggregation of all bases.

Section 3.16 Output Smoothing Method. In general, we support the proposal to include guidance related to output smoothing methods. We recommend a minor change to Section 3.16 to better reflect plans that have incorporated output smoothing into the structure of their amortization payments and suggest the body of Section 3.16 follow the text of 3.16(a) by referring to "a corresponding actuarially determined contribution without output smoothing." Then subsections (a), (b) and (c) should all refer

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to "the corresponding actuarially determined contribution without output smoothing." This would add the words "without output smoothing" to subsections (a) and (c).

In addition, we recommend that Section 3.16 guidance on output smoothing be made consistent with the ASOP No. 44 guidance on the selection and use of asset valuation methods. We note 3.16(a) and (b) closely follow Sections 3.3(b)(1) and 3.3(b)(2) of ASOP No. 44. However, Section 3.3 of ASOP No. 44 also includes the following additional guidance:

> "In lieu of satisfying both (1) and (2) above, an asset valuation method could satisfy section 3.3(b) if, in the actuary's professional judgment, the asset valuation method either (i) produces values within a sufficiently narrow range around market value or (ii) recognizes differences from market value in a sufficiently short period."

We recommend Section 3.16 include guidance corresponding to this "sufficiently narrow range" and "sufficiently short period" guidance from ASOP No. 44 Section 3.3.

Section 3.20 Reasonable Actuarially Determined Contribution. We agree an actuary performing a funding valuation should calculate and disclose an Actuarially Determined Contribution (ADC). We support the disclosure of an ADC for all plans when performing a funding valuation, including plans where the funding policy (as referenced in Section 3.19) may determine contributions without reference to an ADC, such as a plan with a statutorily fixed contribution rate. For such plans, we recommend the ASB say the ADC should be determined independent of the any non-ADC based funding policy, rather than being developed to match the contributions set by such funding policy.

We also concur with the guidance of Section 3.20(b) that the normal cost should be should be based on the plan provisions applicable to each participant.

* * * *

Bartel Associates believes our standards of practice should remain principles based and avoid imposing prescriptive requirements on actuaries, particularly requirements that do not fulfill some universally applicable purpose. Accordingly, while we concur with most of the proposed changes we strongly recommend against the proposal that the IRDM be made a required disclosure as part of every funding valuation. If the IRDM disclosure requirement is retained, then any "should disclose" requirement should be changed to "should consider disclosing."

We appreciate your consideration of these comments and please do not hesitate to contact us if you have any questions.

Sincerely,

John E. Bartel
President

c: Mary Beth Redding, Bartel Associates
Doug Pryor, Bartel Associates
Marilyn Oliver, Bartel Associates
Bianca Lin, Bartel Associates

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Comment #58 – 7/31/18 – 8:58 p.m.

Date: July 30, 2018

To: Actuarial Standards Board

From: James Donofrio, FSA, MAAA

Subject: ASOP No. 4 Exposure Draft of March 2018

These comments reflect my personal opinion and are not necessarily shared by my employer.

I support the proposed revisions to ASOP No. 4 in the expectation that they will assist stakeholders to better understand the risks undertaken by sponsors of defined benefit pension plans. In particular, participants in such plans need more information about how the sponsors of their plan are securing the benefit promises that have been made to them, what risks threaten their benefit security and how those risks are or are not being mitigated.

The fact that over one million participants in distressed multiemployer plans are facing the possibility of a default on pension promises in the foreseeable future and that possibly many others in severely underfunded state and local government plans will eventually face similar issues provides compelling justification for requiring that the actuaries providing valuation services to pension plans include information on the risks to benefit security in their reports.

It is clear that while a combination of circumstances has contributed to the financial challenges of distressed plans, the absence of a market-consistent liability or an Investment Risk Defeasement Measure (IRDM) can obscure the true level of risk while it is emerging, and while it may still be practical to implement remedial measures.

The opposition to such disclosures is not at all persuasive. Some suggest that the volatility of these measurements will confuse stakeholders. Yet most Americans own a home and understand that the volatility in its value is not irrelevant to their financial security. Some conflate the volatility of such a funded status metric with the challenges of a volatile contribution or cost requirement. But there are many ways to smooth contribution requirements within the framework of the revised standard (up to a point). Some even suggest that political motivations are driving the proposed IRDM disclosure requirements, which is inappropriately dismissive of the financial economics perspective on the measurement of pension obligations.

While the overall direction of the proposed revision is definitely an improvement, there are some aspects that could be refined. For example, plans that already disclose liability measurements that utilize market-based discount rates (such as plans subject to ASC 715) should be able to use those measurements to comply with the revised standard.

The draft requested comments on two specific issues:

1. The discount rate choices specified for the IRDM (either U.S. Treasury yields or yields of fixed income debt securities in one of the two highest ratings categories) are appropriate.
2. The conditions listed in section 3.20 regarding the process of arriving at a Reasonable Actuarially Determined Contribution as drafted does describe an appropriate allocation procedure.

July 31, 2018

ASOP No. 4 Revision
Actuarial Standards Board
1850 M. Street, NW, Suite 300
Washington, DC 20036
Re: Comments on ASOP4 Exposure Draft

Dear ASB Members:

On behalf of Findley we are pleased to submit the following comments on the proposed revision to the Actuarial Standards of Practice 4 (ASOP 4).

In regards to section 3.11 involving the Investment Risk Defeasement Measure (IRDM), we think the term itself is confusing and misleading. The entire term and its intended purpose is not clearly defined in the ASOP. If we interpret the meaning to be a measurement that defeases all risk, we still view the term IRDM as misleading. The only way to completely eliminate the risk of a pension obligation is to terminate the plan. If that is the purpose of providing this measure could this just be coined the Termination Liability Measurement or something similar to be more informative to a client. In addition, our principals typically determine when they need this calculation. Adding it as a requirement seems overly burdensome to principals who aren't concerned about plan termination.

The options provided for valuing this measure are to base discount rates on U.S. Treasury yields or yields of fixed-income debt securities that receive AA or AAA ratings. These seem like reasonable rates on the surface. However, we question the availability of the AA and AAA bonds to completely match some of the larger pension obligations. Also, there is default risk inherent in the corporate bonds. We do not believe that the use of these bonds clearly identifies a risk free liability.

From a private employer perspective, we do not see how this calculation is much different from the requirements under US accounting standards. The language for determining the discount rate is very similar to the language used in US accounting standards. It seems that the purpose of this requirement is to require a market-based liability calculation for public pension plans. It doesn't seem that the ASB should be overly prescriptive on this topic and it should let the governing bodies of these plans determine the required liability calculations.

The relevance of this liability measure as part of regular valuation process is also questionable. Typical valuation liabilities are valued as of the beginning of the plan or fiscal year. These reports may be issued months or even over a year after the beginning of the plan or fiscal year. It seems counterintuitive to provide a principal with a retrospective estimate of the IRDM, when more current yields are available to calculate.

In a typical year plan private plan sponsors are given the following liabilities:

- Funding Target using BBA segment rates
- Funding Target using pre-MAP 21 segment rates
- Funding Target using PBGC Rates
- Funding Target using 4010 assumptions and interest rates
- At-Risk Funding Target using BBA Relief Rates
- Projected Benefit Obligation using agreed upon discount rate
- Accumulated Benefit Obligation using agreed upon discount rate
- Defined Benefit Obligations using agreed upon discount rate for international plans
- Potentially other liability measures for certain scenarios

Another mandated measurement may not provide much value to the entities that our profession is looking to service. Most entities that have termination on the horizon have or can ask their actuaries to provide them with a current termination liability estimate, which would provide more up to date and pertinent information than another liability measurement in a report referencing the beginning of the plan/fiscal year.

As actuaries, we understand the esoteric reasoning for including such a measure into a valuation report. However, we do not think the measure, as currently defined, provides much, if any value to the clients paying for the determination of the measure. We also feel it is odd that the freshly minted ASOP 51 has no mention of this measurement. ASOP 51 was created to incorporate more risk management awareness into the day-to-day pension world, which is a good thing. It seems like an irregular oversight to place an IRDM type measurement in ASOP 4 and not mention it anywhere in ASOP 51.

The procedure described to formulate "Reasonable Actuarially Determined Contribution (RADC)" in Section 3.20 seems reasonable. We think you could argue that implementing an output smoothing method can be at odds with procuring the assets necessary to make benefit payments when due, but we think that the actuary should reasonably be able to use the procedure to formulate the "RADC".

The remaining changes to the ASOP appear to be reasonable. However, the overall tone of the revisions to ASOP 4 tends to be more prescriptive versus taking a principles-based approach to drafting the ASOP. The Standards of Practice have been built using a principles-based approach to setting standards. While some of the revisions make sense, I don't agree with the more prescriptive tone of the ASOP.

Thank you again for spending the time revising ASOP 4. While we feel the idea of the IRDM is a bit overreaching, it is always wise to review our ASOPs for current day needs, so we thank you for the time spent going over this.

Respectfully,

Adam Russo, ASA, MAAA
Consultant

Larry E. Scherer, FSA, EA, MAAA
Managing Consultant

Comment #60 – 7/31/18 – 9:51 p.m.

Actuarial Standards Board,

I am writing some general comments related to ASOP 4 as informed by ASOPs 41 and 51. I am pleased to see and applaud the thoughtful interplay of these standards. They reflect our profession's continued advancement of the critical value and responsibility that actuaries can provide their clients. Clients need context to understand any numbers that may be provided by an actuary. As there is always risk and uncertainty associated with any valuation of the future, numbers reported are only ultimately useful if they also contribute to the framing of sustainable risk management awareness and actions. I believe lifetime retirement income is a valuable benefit and should be encouraged in a sustainable fashion.

I appreciate that the topic of market based valuations for public pension plans has been a controversial topic for almost two decades. Whereas in the past, the debate was often couched in terms of which basis was the "true" basis, my experience has been that the use of multiple lenses (along with understanding the value and shortcoming of each lens) is essential for the sustainable management of long term obligations and to understand the possible range of results. Cashflows from funding and for payments are done and reported in the real world, but credit and market risk need to be assessed by comparing ones current, real world holdings against the risk views of the rest of the market. Combined with a gain and loss analysis based on the sources of risk, managers of the risks can then understand and clarify the level of risk that the program may be willing to tolerate (and to clarify who shares in any of the wins and losses from taking on extra risk).

I have heard there is concern that reported market numbers may be misused by others and may actually confuse the managers of those programs. As to the first concern, those numbers are already being used as political weapons without any professional obligation by others to include the context (and possible misapplication) of market based numbers. These ASOP's reinforce the important opportunity and role for the actuary to provide a balanced and educative view of the possible range of results and risk exposures so that the managers of the programs are better equipped to enter into the needed public discussion and sustainability of those programs.

I must admit that in some ways, these are not my views alone, as I arrived at many of them after being asked to chair a Task Force to report to the board of the American Academy of Actuaries almost 10 years ago. We were asked to recommend options to improve the sustainability of public pension plans in the US. My own experience at a company focused on providing lifetime income protection and the valuable education I received from working with that diverse and passionate group of pension practitioners is the basis for the comments expressed here.

David K. Sandberg MAAA, FSA, CERA

TERRY

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July 31, 2018

Actuarial Standards Board
1850 M Street, NW, Suite 300
Washington, DC 20036

RE: COMMENTS ON PROPOSED REVISIONS TO ASOP 4, 27, AND 35

Members of the Actuarial Standards Board,

Thank you for the opportunity to offer our comments and suggestions regarding the exposure drafts containing the proposed revisions to:

- ASOP 4 – Measuring Pension Obligations and Determining Pension Plan Costs or Contributions
- ASOP 27 - Selection of Economic Assumptions for Measuring Pension Obligations
- ASOP 35 – Selection of Demographic and Other Noneconomic Assumptions for Measuring Pension Obligations

We are strongly supportive of these proposed revisions, which introduce important new disclosure requirements for pension actuaries performing funding valuations. Our comments and suggestions for your consideration follow:

ASOP 4

Section 3.11, Investment Risk Defeasement Measure

Purpose

We strongly support the concept of a required disclosure of a liability measure that is uniformly calculated on a market-consistent basis for all pension plans. Such a liability measure provides a meaningful, transparent, and trackable metric for the plan sponsor and/or the entity responsible for funding the plan, as well as to other stakeholders. By making the liability measure independent of the sponsor's investment strategy, it facilitates a better understanding and tracking of a plan's funded status, and facilitates a relevant comparison of a plan's funded status to that of other plans or systems. Currently, this critical information is generally unavailable in the published reports of public pension plans.

Name

In our view, the proposed name, Investment Risk Defeasement Measure (IRDM), does not capture the essence or the value of this additional liability measure. It can even be misleading because the real value of this liability is as a point-in-time, market consistent, transparent solvency measure.

We believe a more straightforward name like “market-consistent present value of accrued benefits” or “proxy settlement value” is more descriptive, as well as more indicative of the calculation methodology and the relevance of this required disclosure.

Calculation elements

We support the use of what is essentially a unit credit actuarial allocation method and agree that the measure should reflect low-risk discounting. This liability calculation method relies on a straightforward discounting of projected cash flows at an appropriate discount rate, much like typical market instruments. Among the array of different actuarial cost allocation methods, we believe that the method required for this important liability disclosure is the only method that will replicate a market process on a consistent basis. Further, particularly for disclosure purposes, we support this degree of prescription.

We note that in the public sector, future benefit accruals are often protected by the state’s constitution. In those situations, some might believe that such future benefits are already “accrued.” As such, it may be worth reinforcing that, under 3.11(a), “benefits accrued as of the measurement date” do not include the impact of future accruals, even if so protected.

Section 3.14, Amortization Methods

We support the added focus on amortization methods contained in section 3.14, which helps shine a light on the excessive deferral of costs/contributions.

Section 3.16, Output Smoothing Methods

We believe the expansion of the definition of output smoothing will be useful, and the added focus may encourage actuaries to consider the value of smoothing outputs over inputs.

Section 3.20, Reasonable Actuarially Determined Contribution

We support the disclosure of a reasonable actuarially determined contribution when the determination prescribed by the plan sponsor is not. In general, we would expect that actuaries would fulfill this requirement by bringing in line those elements that fall outside the actuary’s judgment of reasonable. However, flexibility in this determination is appropriate as in some cases the contribution is prescribed as an amount, not as the result of a calculation. Further, we could envision that some actuaries may prefer to use a standard, reasonable alternative across all their clients, irrespective of the particular methods or assumptions in question for a given client.

ASOP 27

Section 3.6.3, Phase-In of Changes in Assumptions

We respect the desire to provide guidance on the phase-in of assumption changes over multiple measurement dates. But as we read it, the guidance merely reinforces that the “regular” rules apply at each measurement date. And given that the environment at a future measurement date cannot be known today, a phase-in merely becomes a statement of intent. As such, we question the value of giving this topic its own subsection, and suggest the reinforcement of the underlying principles be handled either in the appendix or embedded in a section such as 3.13

on reviewing assumptions. Alternatively, the subsection could be retained, but the structure changed to convey that a phase-in is acceptable if the assumptions at the current measurement date are reasonable, and the assumptions at each future stage of the phase-in are reasonable at the respective future measurement date.

Section 4.1.2, Rationale for Assumptions

We agree that an actuary should provide his or her rationale for supporting assumptions selected by another party. We believe it should be made more clear that the intent is that, with respect to a *significant* assumption selected by another party, the actuary should make a determination as to its reasonableness and disclose such determination.

ASOP 35

Section 3.4, Phase-In of Changes in Assumptions

See related section under ASOP 27 comments above.

Section 4.1.2, Rationale for Assumptions

See related section under ASOP 27 comments above. In addition, we support the added disclosure around the use of older mortality tables.

We appreciate your consideration of our comments. If you have questions, you may reach us via John Moore at 720-504-7974 or john.moore@terrygroup.com.

Sincerely,

Thomas S. Terry, MAAA, FSA, FCA, EA
CEO

John H. Moore, MAAA, FSA, FCA, EA
COO and Chief Actuary

Elena Black, PhD, MAAA, FSA, FCA, EA, CFA
Principal and Senior Research Actuary

Liaw Huang, PhD, MAAA, FSA, FCA, EA
Principal and Senior Research Actuary

Brian M. Septon, MAAA, FSA, FCA, EA
Principal

PTA

William B. Fornia, FSA | President

July 30, 2018

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

Dear Board Members:

I have reviewed the recently released exposure draft of a proposed revision to Actuarial Standard of Practice (ASOP) No. 4, *Measuring Pension Obligations and Determining Pension Plan Costs or Contributions*. I limit my comments to **Section 3.11** of the proposed standard:

1. For many reasons, which are included in other comment letters, I believe that the "Investment Risk Defeasement Measure" ("IRDM") as defined in Section 3.11 is fundamentally flawed as a generally applicable measure of risk.

2. IRDM is clearly identical to values previously known as "Market Value of Liabilities" and "Solvency Value". Renaming the measure doesn't change it or somehow make it more useful.

3. I find that this measure is of little use and easily misleading, and would prefer not requiring its inclusion as a mandatory disclosure item. However, I am particularly concerned with the pretense that IRDM is an "Investment Risk Defeasement Measure." It is not.

   a) Even if assets were invested in risk free securities, with return equal to the discount rate in the IRDM calculation, the investment risk would not be defeased. This is because actuarial measures in IRDM are calculated using unit credit actuarial valuation method, while benefits are promised in line with other projected benefit actuarial methods, typically entry age normal. A square peg measured in inches and compared to a round hole measured in centimeters is not meaningful.

   b) Many plans provide benefits which are responsive to investment returns. These include Wisconsin Retirement System, South Dakota Retirement System, Colorado Fire and Police Pension Association, and many statewide Ohio systems, to name only the ones that I am most familiar with. For these plans, investment risk is in large part defeased through benefits being adjusted. Others have employee contributions being adjusted. For these plans in particular, the IRDM misrepresents the investment risk that is being defeased.

4. Finally, I am a signatory to two group letters (CCA public plans steering committee and an unaffiliated group of public pension actuaries). Please also consider their comments as my own.

I appreciate the opportunity to provide feedback on the proposed revisions to ASOP No. 4 and would be happy to discuss comments in greater detail.

Sincerely,

WB Fornia

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Sent via e-mail to comments@actuary.org

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

July 30, 2018

Subject: Proposed Revision of Actuarial Standard of Practice (ASOP) No. 4

I would like to thank the Actuarial Standards Board (ASB) for the opportunity to provide comments on the proposed revision of ASOP No. 4. These brief comments largely focus on section 3.11 "Investment Risk Defeasement Measure" and certain semantic issues. The primary reason for this brevity is that most of my comments on the previous revision of ASOP No. 4 are still valid. I would like the ASB to consider these comments for this revision as well.

Section 3.11 "Investment Risk Defeasement Measure" contains the most consequential changes to the proposed standard. This section explicitly introduces the concept "*a hypothetical bond portfolio whose cash flows reasonably match the pattern of benefits expected to be paid in the future*." I consider the introduction of this concept a major step in the right direction, even though the concept has substantial room for improvement.

By virtue of utilizing "hypothetical bond portfolios," this ASOP ventures into the area of portfolio selection; by virtue of calling section 3.11 "Investment Risk Defeasement Measure," this ASOP ventures into the area of risk management. The former should be encouraged; the latter should be avoided.

Perfectly matching bond portfolios do not exist for most plans. It is true that the market price of a hypothetical matching bond portfolio may be informative in some cases. Still, requiring actuaries to express opinions on the risk-mitigating properties of these portfolios may not be a good idea. Real life investable bond portfolios may or may not reduce the riskiness of pension plans. Section 3.11 should be entitled "Market Values of Relevant Buy-and-Hold Assets" or something close to it. "Risk defeasement measures" do not belong to this ASOP.

Furthermore, "hypothetical bond portfolios" do not have to match *all* the "benefits expected to be paid in the future." For example, it may be valuable to estimate the market value of a bond portfolio that matches the benefits for a sub-group of plan participants (e.g. retirees and beneficiaries) or even first *N* years of these benefits. As another example, it may also be valuable to estimate the market value of a bond portfolio that matches the excess of benefits over expected contributions in the next *N* years.

Thus, there is no need to require "hypothetical bond portfolios" to "reasonably match" benefits – these portfolios may be useful even if they only offset some benefits. The standard should recognize that there may a multitude of "buy-and-hold" assets relevant to retirement plans – matching and non-matching. Actuaries should have wide latitude to utilize reasonable methods to estimate the market values of these assets.

The presence of hypothetical matching bond portfolios makes "market-consistent present values" obsolete. The concept of "market-consistent present values" is neither useful nor necessary. The term "market-consistent present value" should be replaced by "the market value of the hypothetical matching bond portfolio" throughout this ASOP.

To recap, I propose the following changes:

1. Section 3.11 should be entitled "Market Values of Relevant Buy-and-Hold Assets" instead of "Investment Risk Defeasement Measure,"
2. The term "investment risk defeasement measure" should be eliminated.
3. In section 3.11, the phrase "the actuary *should* calculate" should be replaced by "the actuary *may* calculate."
4. Section 3.11 should state that the actuary may estimate and disclose the market value of any "buy-and-hold" asset that may be relevant and beneficial to the plan. Such "buy-and-hold" assets include but are not limited to hypothetical matching bond portfolios.
5. If "a hypothetical bond portfolio whose cash flows reasonably match the pattern of benefits expected to be paid in the future" is deemed relevant to the plan, then the actuary should estimate and disclose its market value.
6. The term "market-consistent present value" should be replaced by "the market value of the hypothetical matching bond portfolio."

Let us address certain semantic issues related to this standard. The exposure draft of the January 2012 revision of ASOP No. 4 contains the following remarkable statement:

> "*The word "liability" has created challenges for actuarial communications for decades and continues to do so today*."

While this statement is undeniably true, it does not go far enough. The terminology currently used by the pension actuarial community has created challenges for actuarial communications for decades and continues to do so today. I would like to encourage the ASB to consider the following suggestions:

1. Cash flows and their present values should have different terms. In general, I propose to use the term "commitment" for cash flows and the term "required assets" for present values.
2. The term "liability" should be avoided whenever possible. In many cases, the term "required assets" would be more appropriate.
3. The term "obligation" should be used only for the purposes statements of the Financial Accounting Standards Board (e.g. projected benefit obligations, accumulated benefit obligations).
4. The term "retirement commitments" should represent payments to retirement plan participants and beneficiaries (commitments out-flows) and plan sponsor's contributions to retirement plans (commitments in-flows). ASOP No. 4 should be called "Measuring Retirement Commitments." The present value of future benefits (PVFB) would be an example of a commitments out-flow measurement. The present value of future normal costs (PVFNC) would be an example of a commitments in-flow measurement.

In recent years, the ASB has occasionally proposed and adopted short-term temporary fixes to emerging fundamental problems. The current revision contains certain reflections of this unfortunate trend. I would like to urge the ASB to embrace long-term solutions and reconnect the standard to the key principles of actuarial science and finance in general.

Thank you for your attention to these comments. Feel free to contact me if you have any questions/comments. I would be happy to assist the ASB in the development of this standard and related issues.

Sincerely

Dimitry Mindlin, ASA, MAAA, Ph.D.
President
CDI Advisors LLC
dmindlin@cdiadvisors.com
www.cdiadvisors.com

Comment #64 – 8/1/18 – 5:11 p.m.

Dear ASB members,

I applaud your efforts to continue to improve pension standards. Overall the revisions to these standards are much needed, and I support them. Below are some specific comments for your consideration.

<u>ASOP 4</u>
I support the key changes, including addition of a required disclosure of defeasement measure. However I have a suggestion for improvement. I believe further guidance regarding the construction of a hypothetical bond portfolio in determining an appropriate discount rate would be helpful. Current practice in this area is wide ranging, and in some instances actuaries may be "cherry picking" bonds to maximize the discount rate. If further guidance could be added to the ASOP to limit such practice I think it would be helpful to the intended user of the actuary's report. For example, requiring that such hypothetical bonds be "representative of actual instruments that could be purchased at the valuation date." I also suggest that the disclosure in item 4.1.o should explicitly require disclosure of the discount rate and the method used in its derivation.

<u>ASOP 27</u>
I support the key changes.

<u>ASOP 35</u>
I support the key changes. In section 3.5.3.a I would suggest adding the word "recent" between the words "and" and "generally" to clarify that generally available but outdated mortality tables should typically not form the basis of the assumptions.

Thank you for considering these comments.

Tricia Matson

Comment #65 – 8/2/18 – 10:41 a.m.

Good morning,

I briefly reviewed

MEASURING PENSION OBLIGATIONS AND DETERMINING PENSION PLAN COSTS OR CONTRIBUTIONS
STANDARD OF PRACTICE

and I would like to comment on this.

We are a small town of 3500. We offer a small pension to volunteer firemen who have offered their services for 20 years or more to keeping our community safe. This is $100 per month. The surviving spouse receives $50. Currently there are 21 people receiving this. Last year's expenses were just under $25,000.

What you are proposing would enforce onerous administrative fees for our plan. Would you consider an alternative measurement option for small plans with a workable formula? This is taken from Montana law:

assets in the fund are maintained at a level equal to at least three times but no more than five times the benefits paid by the fund in the previous or current fiscal year, whichever is greater;

This would be a sensible approach in our situation and others that would qualify and still offer some semblance of reasonableness to determine if a pension plan is soundly funded.

Thank you for your time and consideration,

Michelle Dyckman
Finance Officer/City Clerk
City of Hardin
406 N Cheyenne
Hardin MT 59034
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Comment #66 – 8/2/18 – 3:32 p.m.

MEASURING PENSION OBLIGATIONS AND DETERMINING PENSION PLAN COSTS OR CONTRIBUTIONS
STANDARD OF PRACTICE

The following is my comments on the above:

It seems ironic and a bit hypocritical that when the State of Montana passed a law that is fitting for the city/towns within it that GASB can come along and put in a ruling that results in a finding in our audits as well as a cost to our taxpayers even though we are complying with Montana Law.

Our town has about 2500 citizens-we have about 20 retired firefighter pensions paid out monthly at a rate of $170/retiree.

We have met the requirement of the State of Montana for the three years of payments however the GASB requirements would instill another fee for an actuary that doesn't do anyone any good. If we are meeting Montana Law that should be good enough, it passed our legislative scrutiny to become a law. They realized and appreciated the fact that the taxpayers of Montana should not have to pay someone from out of state to come in, charging each city/town at least $3,000 for this actuary every two years. They would much rather see the taxpayer's dollars spent on the firefighters actual retirement.

I am pleading with you to allow the State of Montana cities/towns to follow Montana Law. This is an excerpt from Montana Law: ***assets in the fund are maintained at a level equal to at least three times but no more than five times the benefits paid by the fund in the previous or current fiscal year, whichever is greater;***

Agnes Fowler
Finance Officer-City of Conrad

NPPC EVERY AMERICAN DESERVES TO RETIRE WITH DIGNITY.

July 30, 2018

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

Dear Members of the Actuarial Standards Board:

The National Public Pension Coalition (NPPC) respectfully submits these comments to the Actuarial Standards Board (ASB) for the record regarding the proposed changes to ASOP #4.

NPPC has grave concerns that the process being used to formulate these proposed changes is a political one and that the outcome, if the proposed changes are approved, would be to provide a political weapon to opponents of public pension plans. Public pensions have been under constant attack for the past decade, but the focus of criticism keeps changing. Recently, pension critics have focused on the discount rate, or assumed rate of return, of public pension plans. Despite decades of evidence that public pension plans can meet or exceed their discount rate, these critics argue that the discount rates are too high and must be dramatically lowered. Such an action would be detrimental to both taxpayers and public employees alike.

Most public pension plans receive revenue from three sources: employee contributions, employer contributions, and investment earnings. Revenue from investment earnings typically constitutes somewhere between two-thirds and three-fourths of all revenue in a public pension fund. This makes the discount rate a very important determination for pension plan managers and they rely on the accurate and objective work of actuaries to determine this important number. The proposed changes to ASOP #4 would bias this work and lead to negative outcomes for taxpayers, public employees, and retirees.

The proposed requirement that public plan actuaries calculate an Investment Risk Defeasement Measure (IRDM) is both unnecessary and potentially harmful. Unlike defined benefit pension plans in the private sector, public pension plans are not at risk of being either shut down or having their assets and liabilities sold to an insurance company. As such, the IRDM serves no purpose for public plans. In many cities and states, it would be unconstitutional and, therefore, practically impossible to close down a public plan and sell its assets and liabilities. In this context, the only purpose for calculating an IRDM for public plans is to give political fodder to opponents of public pensions who seek to scare politicians into eliminating public pensions for future generations of teachers, firefighters, police officers, sanitation workers, and other public employees.

We list several other comments and concerns about the proposed changes to ASOP #4 below.

Comment #1: Exception Made for Narrowly Prescriptive ASOP

It's clear that this particular ASOP will violate the ASB's own norms, outlined in ASOP #1, Section 3.1.4, which do not allow for "narrowly prescriptive" rules. ASOPs should "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.

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Comment #2: Concern About Rigged Process

We are also concerned about the process used to formulate these proposed changes. It appears that pension actuaries were excluded from the "Pension Task Force" that developed the proposed changes to ASOP #4. This suggests that the Pension Task Force was specifically stacked with individuals hostile to public pension plans, who would be willing to support changes detrimental to public plans. We urge the ASB to be transparent about how these members were selected and whether any undue political influence biased the selection process.

Comment #3: Calculating an IRDM Would Add Undue Cost to Public Plans

In addition to the potentially harmful uses of the IRDM number, requiring public plans to pay for their actuaries to calculate this proposed figure would add an undue and burdensome cost to public pension plans. This is especially concerning since they would be required to calculate a number that would likely be used against them politically. NPPC supports the already existing, robust framework that public plans follow to disclose their assets, liabilities, and risk.

Conclusion

NPPC respectfully urges the ASB to reconsider the proposed changes to ASOP #4, particularly the proposed requirement for actuaries to calculate an IRDM. These changes could threaten the millions of active and retired public employees and their family members who depend on their public pension for security and reliability in retirement.

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

Sincerely,

Bridget Early

Executive Director

National Public Pension Coalition