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-actuarily 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.