STATE OF CALIFORNIA

California Actuarial Advisory Panel

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November 7, 2014

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

RE: ASOPS- Public Pension Plan Funding Request for Comments

The California Actuarial Advisory Panel (CAAP) was created by the passage of Senate Bill 1123 of the 2008-2009 legislative session and consists of eight public sector actuaries appointed by various appointing powers pursuant to (California) Government Code Section 7507.2. CAAP submits these comments in response to the Actuarial Standards Board's Request for Comments on ASOPs Related to Public Pension Plan Funding and Accounting. We do believe that an improvement in standards would help the actuarial community and those we serve. Generally, standards should be principals based, with some more prescriptive principals in certain areas. These additional standards should be incorporated into currently published standards and therefore apply to all types of pension programs.

1. *Public plan funding and associated actuarial valuations are* less *uniformly regulated than those of private sector pension plans. Actuaries may be asked by their principal to advise on funding levels.* Is *additional guidance needed, beyond that in the recently revised pension* ASOPs, *regarding appropriate public plan actuarial valuation practice to* assist *actuaries in performing their work and advising their principal? Why or why not?*

   While the American Academy of Actuaries, Conference of Consulting Actuaries and CAAP have issued and continue to work on additional guidance for funding of public pension plans, this guidance is not mandatory. We believe some additional guidance from the ASS would be helpful, even if

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not strictly needed, as actuaries are best qualified to provide guidance to improve pension practices.

As further discussed in response to Question 5, given there are various levels of regulation currently for public plans – private sector qualified and nonqualified plans, and church plans - we believe any additional guidance would be most appropriate and helpful if applied broadly, not just to public plans.

Regardless of why additional guidance is issued, if issued, it must be developed via a clear and open process responding to comments in a timely manner that allows for discussion and discourse.

2. *If yes to question 1, in what areas is additional guidance needed?*

One important principle that is absent from the ASOPs is the relationship between contribution policy and intergenerational equity for all types of plans. Other principle-based guidance could address a few of the more outlying practices. These should be very limited but could require that (1) selection of actuarial cost methods should reflect benefits being earned by each member (thereby precluding "ultimate entry age" cost method) and (2) an amortization policy should, at a minimum, ensure that the unfunded actuarial accrued liability will decrease over a reasonable timeframe (thereby precluding any combination of "rolling amortization" with "negative amortization").

There are certain areas that current standards do not cover for any plans, such as risk-based disclosures, employers not making sufficient contributions, and participant benefits at risk of being decreased or forfeited, especially in the wind-up or termination of a plan. The ASB may want to consider requiring additional principle-based disclosure regarding:

a. potential contribution volatility;
b. potential funding level volatility;
c. plan maturity, and
d. benefit security.

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We are aware that a new ASOP on disclosure of risk is in process and will likely address some or all of these issues.

3. *If yes to question 1, should that guidance take the form of* a *separate public plan actuarial valuation standard or be incorporated within the existing ASOPs? Why or why not?*

We believe that any new guidance on actuarial valuations should be incorporated into existing ASOPs (including the forthcoming ASOP on risk). In particular, new guidance on contribution allocation procedures should be incorporated into either ASOP 4 (for cost methods and amortization policies) or ASOP 44 (for asset valuation methods). . Similarly any guidance on actuarial assumptions should be incorporated into ASOP 27 or ASOP 35. Incorporating any new guidance into these existing ASOPs, which already define their subject matter well, would help avoid any redundancies or inconsistencies.

Note that there is a closely related question as to whether any new guidance (in existing ASOPs or in a new ASOP) should apply to all plans or only to public plans. We address that issue in our response to Question 5.

4. *In general, the ASOPs are principles based and not rules based. As a result, the ASOPs are generally not highly prescriptive. Should the ASOPs related to public plan actuarial valuations be more prescriptive? If so, in what areas?*

We believe the current principles-based ASOP approach is appropriate for all areas of actuarial practice. Nonetheless, in some areas, principles can be developed that have the effect of providing guidance that is more prescriptive without necessarily being rules based. We provided two such examples in the first half of the answer to question 2.

Pension plan design, maturity, funded status, etc. vary greatly from one plan to another. A principles based approach can accommodate this diversity. CAAP's experience in developing rules based guidance is that the variety of plans is problematic in many situations.

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5. *The ASOPs have provided guidance that has been applicable to all areas of practice in the pension community (for example, private sector, multiemployer, public sector). If you believe that additional guidance is needed for public plan actuarial valuations, should any of that additional guidance also apply to nonpub/ic sector plans? Why or why not?*

We believe that any additional guidance, if provided, should not apply only to public sector plans but should apply to all pension plans -- public, private, church and multiemployer. Some plans (e.g. qualified private sector) are subject to regulations that are likely more restrictive than any guidance that might be developed, but the guidance would still be valid. Many concepts such as volatility management and intergenerational equity are important for all plans. Guidance should encourage all actuaries to follow practices that help employers/employees and interested parties understand future contribution, expense and funding levels, including volatility.

As indicated in the response to question 2, there are various areas where guidance is lacking for all pension plans. The entire pension actuarial community, which also includes unfunded plans and nonqualified plans, will benefit from a more robust discussion of pension funding issues. The process for this discussion must include significant input from actuaries that work in all pension areas for any guidance to be accepted by the profession as well as those that rely on the profession. We believe all (private qualified and unqualified, public, church and multiemployer) pension plan actuaries will benefit from this additional guidance.

6. *The current definition of an "intended user" of an actuarial communication is "any person who the actuary identifies as able to rely on the actuarial findings" (ASOP No. 41, Actuarial Communications, section 2.7). Should the ASOPs require the actuary for public pension plans to perform additional, significant work (which would be incorporated in the guidance provided in the ASOPs) that is not requested by the principal if that work provides useful information to individuals who are not intended users? Why or why not? If*

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so, should this requirement be extended to all pension practice areas? Why or why not?

No, the actuary should only be required to provide work for the principal requesting the work. In addition, the actuary should continue to be able to define the intended user. By defining the intended user, the actuary is able to focus on communication that is provided at a level appropriate to those intended users.

One of the most important aspects of the recently revised ASOPs 4 and 27 is the focus on the purpose of the measurement. Whether information is "useful" clearly relates to the use or purpose intended by the user. For that reason the usefulness of any information should be evaluated and determined by the principal, since it is the principal who determines the purposes for which the valuation is performed. Otherwise, information could be provided for purposes that are inconsistent with those of the principal, who generally has a fiduciary responsibility for the good operation of the pension plan. Such information could also be inconsistent with Precept 8 of the actuarial Code of Professional Conduct, if its purposes are so inconsistent with the actual purpose of the valuation as to be misleading.

Furthermore, if additional guidance in this area is issued, it should **not** be limited to public pension plan actuaries. If there are non-principal interested parties for public pension plans then there are similar non-principal interested parties for private pension plans (employees, stockholders, etc.), life insurance companies (policy holders, stock holders, etc.), and other areas of actuarial practice.

In this regard we would observe that the public sector may be the area where there is the **least** need to have the ASOPs enable non-intended users to demand additional "useful information." In the public sector the valuation principal is almost always some public board or agency that is formed of, or appointed by, elected officials, and that operates under open meeting, "freedom of information" and other access and transparency laws. This means a process already exists for users to present their information needs for

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> consideration to the valuation principal. Particularly in the public sector, the ASOPs should defer to these established processes to resolve any disputes as to what constitutes "useful information."

Thank you for considering our responses and please don't hesitate to contact us if you have any questions about them.

Sincerely,

Leslie P. Finertie
Chair, California Actuarial Advisory Panel

cc: Panel members:
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