November 14, 2014

VIA ELECTRONIC MAIL

ASOPs – Public Pension Plan Funding Request for Comments
Actuarial Standards Board
1850 M Street, NW, Suite 300
Washington, DC 20036

To Members of the Actuarial Standards Board:

On behalf of Cheiron, Inc., I am offering our comments on the application of the Actuarial Standards of Practice (ASOPs) in regards to actuarial valuations and other analyses for determining public pension and other postemployment plan funding and accounting. We commend the Actuarial Standards Board (ASB) on requesting comments on this issue.

In summary, Cheiron believes additional guidance is needed for all pension plans, not just public plans. We also believe that this guidance should be addressed under existing and forthcoming ASOPs and should be non-prescriptive. Given the significant decline in defined benefit pension plans in the single employer arena and the looming PBGC multiemployer pension plan crises, we fail to see a clear rationale for focusing solely on public pension plans.

In our opinion, a significant reason for the decline in defined benefit plan sponsorship in all sectors was, and continues to be, the lack of sufficient risk analysis, education, and disclosure. Actuarial pension plan valuation reports today largely resemble those of fifty years ago, primarily comparing this year's static results to last year's.

We believe that the pension industry has been so constrained by prescriptive and constantly changing funding regulations and accounting standards that the actuarial profession has been hindered--if not discouraged--from taking advantage of technology advancements that have benefited other industries, to better address the problems faced by pension systems today.

The balance of our response here answers the specific questions posed by the ASB and is followed by additional supplemental information on this topic.

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?*

   Yes, we would welcome additional guidance with respect to the disclosure of risks given the wide range of actuarial practice. However, we strongly believe that prescriptive regulations would be inappropriate. Also, such guidance is needed for all types of

pension plans not just public plans, as the rules that have regulated private sector pension plans have hardly been effective. (E.g. see the death of DB plans in the single employer arena, and the struggling financial condition of multiemployers plans which may soon cripple the PBGC.)

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

   The current ASOPs just focus on actuarial analysis and adequate pension plan funding assuming all actuarial assumptions will be exactly realized even though the odds of that occurring is at or close to zero. The risks faced by any pension plan needs to be made far more transparent. Increased guidance would be helpful on the need to provide projections on best estimate assumptions and also stress testing them on varying assumptions and scenarios. This type of analysis is required for life insurance solvency testing.

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?*

   It should not take the form of a separate actuarial standard for public plan actuarial valuations. It should either be incorporated into existing standards or take the form of a standard on a specific area of practice (e.g., contribution allocation procedures for a pension plan) that would apply to any actuary making an applicable recommendation for any type of plan.

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?*

   ASOPs should remain principles based. The only area where somewhat (as opposed to highly) prescriptive standards may be appropriate is in terms of disclosures.

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 nonpublic sector plans? Why or why not?*

   The guidance should continue to apply to all areas of practice within the pension community. There is no reason to hold actuaries working on public plans to a different standard than actuaries working on non-public plans where they are providing similar types of advice. The guidance should be based on the type of advice being provided, not whether it is a public or non-public plan.

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

The same principles should apply to all pension practice areas, and it should be based on the information that would be useful to the intended user. That is, even if the principal does not request the information, it could be required by a standard if we believe the information is useful and necessary for the intended user. Also, we recognize that the users of the report may extend beyond the intended users. Actuarial valuation reports must often be relied upon by plan sponsors, boards of trustees, legislators, federal and state regulators, rating agencies and others. However, we do not believe the actuary should be obligated to other users of the report beyond the intended users because an actuary cannot anticipate all the possible users of the report and to attempt to do so would be cost prohibitive.

Supplemental Information

The supplemental information below reviews the various types of defined benefit plans, the funding rules and standards that apply, and discusses some of the issues that arise.

Background

As a starting point, it is appropriate to review the various types of defined benefit pension plans that are found in the United States (other than federally managed retirement systems) along with the principal requirements regarding the actuarial cost method and assumptions used for the plans. In general, the classification of plans is based upon the number of employers and types of employers that sponsor the plan. Plan design may influence how a particular actuarial cost method is applied and the assumptions that are needed, but will generally not influence which set of rules applies. For this purpose, the pension industry has come to divide the plans into five categories. However, the purpose of every plan in each of the categories is the same, namely to provide a secure retirement benefit as promised by the plan to the participants and their beneficiaries. The industry classification of plans is currently as follows:

1. Single-employer plans (including those maintained by a controlled group of companies) maintained by companies and organizations in the private sector. This category includes for-profit and non-profit entities but does not include government plans or non-electing church plans.[1] Single-employer plans may or may not be maintained pursuant to collective bargaining agreements. These plans are typically subject to the minimum funding requirements of the Employee Retirement Income Security Act (ERISA) and the

[1] A non-electing church plan is a church plan that has not made an election to become covered under the ERISA sections that apply to private sector plans.

Internal Revenue Code (Code), as amended by the Pension Protection Act of 2006 (PPA). The actuarial cost method and certain key actuarial assumptions are prescribed by law.

2. Multiemployer plans (also referred to as Taft-Hartley plans) that are established by a Board of Trustees typically consisting of an equal number of union and employer trustees pursuant to collective bargaining. This category of plans is subject to the minimum funding standards as they generally existed prior to the passage of PPA. Accordingly, there is a wide variety of actuarial cost methods that may be used and the assumptions are not prescribed. However, the Board of Trustees may specify the actuarial cost method to be used.

3. Multiple-employer plans that are maintained by companies and organizations in the private sector. This category includes for profit and non-profit entities but does not include government plans or non-electing church plans. This category of plans is generally not maintained pursuant to collective bargaining. For plans that are not cooperative or small employer charity plans (CSECs) the minimum funding standards applicable to single-employer plans apply (either on an employer by employer basis or a plan wide basis). For CSEC plans it appears that a variation of the minimum funding standards as in effect prior to PPA applies (although regulations or other guidance have not yet been issued).

4. Church plans, which are non-electing church plans. This category of plans is not subject to the minimum funding standards of ERISA. As such there is essentially no regulatory requirements (unless found in state law) that impact on how well funded the plans must be.[2] Accordingly, there is a wide variety of actuarial cost methods that may be used and the assumptions are not prescribed.

5. Government plans (including plans of agencies and instrumentalities of state and local governments).[3] This category of plans is not subject to the minimum funding standards of ERISA. Accordingly, there is a wide variety of actuarial cost methods that may be used. However, often the actuarial cost methods and key assumptions are specified by state or local law.

The accounting standards overseen by the Financial Accounting Standards Board (FASB)[4] and the Governmental Accounting Standards Board (GASB) provide rules for treatment of pension plans from an accounting standpoint. In general, the FASB rules generally apply to non-governmental plans, and prescribe the actuarial cost method that must be used to determine the expense and balance sheet liability. The GASB rules generally apply to

[2] Note there is currently much litigation as to whether some of these plans (covering thousands of participants) are really church plans.

[3] There is still uncertainty as to whether certain plans are subject to ERISA. The IRS published a request for comments a while ago along with a proposed regulation draft. It is not clear when the IRS will publish an actual proposed regulation.

[4] The International Accounting Standards Board (IASB) has requirements similar to FASB and relates to companies operating within the US but with domicile overseas.

governmental plans, and prescribe the actuarial cost method that must be used to determine expense and the balance sheet liability. To a certain extent, the FASB and GASB rules are prescriptive of the certain key assumptions, particularly the discount rates that is to be used, but do not prescribe specific rates as is done for single-employer plans. The FASB and GASB rules do not require that the plans be funded, however, the determination of the balance sheet liability will take into account the level of funding. It is important to note that the current GASB rules are just now becoming applicable to plans, and the impact on plan sponsor and other stakeholder behavior has yet to seen.

Discussion

There are risks associated with every category of plans. In general, the risks are borne by the plan sponsor, the plan participants, and/or other stakeholders depending on the particular risk. Some of the risks are common to all plans (e.g., the risk associated with poor investment return on plan assets), but others may be unique to one or more classes of plans. For example, the risk associated with a continued rise in premiums under the plan termination insurance provisions of title IV of ERISA (administered by the Pension Benefit Guaranty Corporation (PBGC)) applies to single-employer plans and multiple-employer plans, and to some extent to multiemployer plans but not to plans that are not are not covered by title IV. But importantly most risks are common to all plans types and an ASOP covering how the actuarial profession should be engaging plan sponsors in a discussion of risk is required for all plan types. To that end we look forward to the forthcoming exposure draft on the assessment and disclosure of risk that is apparently under discussion (from the August box score issued by the ASB). Many of the concerns that have been expressed with respect to public plans can be addressed by such a standard.

One concern that has been expressed is the failure of the plan sponsor to actually make the contributions to a plan that is determined by the plan actuary under an actuarial cost method. The failure to actually make contributions poses long-term risks to the viability of the plan to say the least. However, the risk associated with the failure to make contributions is not unique to public plans. Plan participants and the PBGC have felt the impact of the failure of private sector companies to make plan contributions and the aftermath of a bankruptcy filing. The participants lose benefits and the PBGC becomes liable to the extent of its guarantees. Non-electing church plans will simply terminate and the participants lose benefits without any guaranty structure.[5] For a governmental plan, the failure to make contributions will now (under the new GASB rules) result in an increase in the liability reported on the balance sheet of the governmental entity. We expect that this will have an impact on the long-term behavior of the plan sponsors. However, for all types of plans, it may well be appropriate to describe the risk posed by the failure to make contributions. Because the risk of failure to make contributions applies to all plans, it is more appropriately addressed in a standard applicable to all plans.

[5] This situation was one that led to the passage of ERISA in the first place.

Another concern that has been expressed is the use of actuarial assumptions that reflect long-term expectations rather than current market conditions. Existing actuarial standards of practice recognize that measurements of plan liabilities may be made on a market-consistent basis, but that the appropriate basis to measure liabilities depends upon the purpose of the measurement. The purpose of the measurement is not something that is or should be mandated by a standard of practice. Accounting requirements, legal requirements, or sound funding policy give rise to the measurements not standards of practice.

A third concern expressed about the funding of public plans is the use of amortization methods that are not to result in the full amortization of the unfunded actuarial accrued liability. Amortization methods such as a "rolling 30-year amortization" have been criticized for both their effect and the lack of disclosure of the effect. We believe that under the new GASB rules (which require disclosure of the actuarially determined contributions) plan sponsors will re-examine their amortization methods and this could result in a curtailment of the continued use of such methods, making the need for any change in actuarial standards with respect to governmental plans premature. In any case, such a method appears to require disclosure under section 4.1.k. of the newest revision to ASOP 4. That could be added as an example. Of course, for some plans (such as non-electing church plans) there is no legal or accounting requirement that would address this concern. Therefore, it is more appropriate to further clarify the impact of amortization methods in a standard applicable to all plans rather than to just governmental plans.

We thank the ASB for requesting comments, and are available to provide further information or respond to any questions that you might have.

Sincerely,
Cheiron

Gene Kalwarski, FSA
Chairman & CEO