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Comment #38 – 11/14/14 – 4:09 p.m.

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ASOPs – Public Pension Plan Funding Request for Comments
Actuarial Standards Board
1850 M Street NW, Suite 300
Washington, DC 20036-4601

Dear Members of the Actuarial Standard Board:

SUBJECT: ASOPs and Public Pension Plan Funding and Accounting

The California Public Employees' Retirement System (CalPERS) supports the ongoing improvement of Actuarial Standards of Practice (ASOPs) and appreciates the opportunity to provide input to the ASB on the issue of Public Pension Plan Funding and Accounting. CalPERS is the largest public pension fund in the U.S., with approximately $300 billion in assets. CalPERS administers health and retirement benefits on behalf of 3,089 public school, local agency, and state employers. There are nearly 1.7 million members in the CalPERS retirement system and more than 1.3 million members in its health plans.

CalPERS' supports the position that NASRA has taken on this issue – that there is no need for *public plan specific* actuarial standards of practice. However, we would like to expand upon that response. Our position is as follows:

a. There are areas where the ASOPs governing actuarial practice in the pension field could and should be improved.
b. ASOPs should be as broadly applicable as possible – similarities between the various subfields within the pension practice area are not sufficient to necessitate separate standards.
c. ASOPs should, for the most part, be based on principles rather than rules.

Professional Standards versus Regulations

The goal of ASOPs should be to distinguish between professional and unprofessional practice, not to choose between otherwise professional practices. Regulation, on the other hand, often has to choose between otherwise acceptable practices.

As an example, both the Projected Unit Credit and Entry Age Normal actuarial cost methods will fund a pension plan adequately and professionally in most circumstances. An ASOP should not prohibit either one, at least for funding purposes. However, regulations often have to distinguish between otherwise acceptable methods for reasons that may not be related to professionalism. The restrictions on the cost method that can be used by private sector qualified plans are reflective of tax considerations, not professionalism.

CalPERS is concerned about implementing, via actuarial standards, constraints on actuarial practice intended to substitute for government regulation. Regulations are different from professional standards and what is appropriate for a regulation may not be appropriate as a professional standard.

Principles Based versus Rules Based Standards

The current standards are generally principle based and are grounded in professionalism rather than other considerations. As such, they have substantial moral authority. This makes both actuaries and others who have the authority to set actuarial assumptions or to require actuarial methods very reluctant to go outside of the bounds prescribed by the ASOPs.

If the ASOPs were instead viewed as being based on rules and selecting specific methods or assumptions based on criteria unrelated to professionalism, they would lose much of their moral authority. If that were to happen, it may become acceptable to plan sponsors or others to prescribe assumptions that require an actuary to qualify their report.

The possible exception to the general rule that standards should be based on principles rather than rules is in disclosures.

Broadly Applicable versus Narrowly Focused Standards

A specific concern is that a narrowly focused standard (such as one applicable just to public pension plan work) would be particularly susceptible to inclusion of overly specific restrictions on practice. These may include restrictions that seem appropriate in general but that may not be appropriate in the circumstances and environment of specific public plans.

One of the best ways to evaluate whether a standard is appropriate would be to broaden the scope and see whether it still makes sense.

Because of the relatively strict regulation of pension practice applicable to qualified plans in the private sector, there may have been a tendency for the actuarial profession to “farm out” the necessary standard setting activities to the federal regulators. In our view, this is inappropriate and bad for the actuarial profession. If actuarial standards are needed, they should apply regardless of whether there are government regulations or accounting standards that also apply.

As an example, consider the issue of whether an ASOP should impose limits on the maximum amortization period that can be used in actuarial valuations of a pension plan. Some may argue that any amortization period greater than the average remaining service life of the active members of the plan is inappropriate and there should be actuarial standards, applicable to public plans, that prohibit longer amortization periods. But the basic argument is equally applicable to pension plans in the private sector. If this is an appropriate restriction to put into a public plan ASOP, then why shouldn't it also apply in the private sector? Even if current regulations applicable to parts of the private sector already limit amortization periods, such regulations do not cover all private sector plans.

Response to Questions

CalPERS offers the following comments on the specific questions asked in the request for comment.

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?*

   Additional *guidance* is needed. It should be noted that other actuarial organizations, such as the American Academy of Actuaries, the Conference of Consulting Actuaries and the California Actuarial Advisory Panel have recently produced documents that provide additional non-binding guidance in a number of areas and are working on providing additional guidance. What is not clear is whether this is sufficient or whether there should be additional *mandatory standards*.

   Some of the practices within the retirement practice area lag behind other practice areas. Of particular concern is the disclosure of risk. Perhaps because of the relatively small size of many of the pension and OPEB plans, risk based disclosures are not as common in the retirement practice area as in other practice areas. While the largest and most sophisticated plans and plans sponsors – in both the public and private sector – may be getting good information about the risks of funding and operating the plans, that is not the case for many plans.

   Additional areas where additional guidance would be helpful are outlined in the response to question 2 below.

Accordingly, some additional mandatory standards would be appropriate and helpful. Such additional standards should apply to all appropriate work in the retirement practice area – whether in the public or private sector, whether the plan is qualified or non-qualified[1].

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

Any new actuarial standards should be directed at restricting situations where actuarial work is viewed as not being of professional quality or is likely to be misleading rather than at simply narrowing the range of practice.

There are several areas where a lack of information in an actuarial report may mislead users of the actuarial report. This is an area where additional standards would be appropriate. Examples of this are:

- A lack of information about the risks taken in the funding of the plan may lead users to underestimate these risks. It would be appropriate to require that there be some disclosures related to these risks. Care will be needed to ensure that the required disclosures are appropriate.[2]
- A lack of information about the consequences of plan wind-up may lead users to assume that a plan with a funded ratio of 100% has sufficient funds to provide for benefits without reduction in the event of plan termination. This may not be correct. Additional information about the impact on plan members in the event of a plan termination would be useful and would help to prevent such a misunderstanding.
- In a situation where a plan sponsor is not making the contributions required to fund the plan, users may assume that the contributions are being made unless this is explicitly discussed in the report.

In addition, spread-gain cost methods are inherently unsuited to disclosing funded status and may be misleading when used as the sole description of the actuarial liabilities. While these methods are well suited for use in determining funding requirements, they should always be used in conjunction with another method for disclosing funded status so as to avoid misleading users of the work.

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?*

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[1] Additional standards should also apply, as uniformly as possible, to actuarial work for both pension and OPEB plans.

[2] A requirement to include an analysis of the sensitivity of the funding requirement to discount rates, interest rates or investment returns would be appropriate for almost all plans and would be consistent with practice in other practice areas. However, it would not be appropriate for a plan that is funded on an immunized basis. Instead, it would be preferable to require an analysis of the sensitivity to key assumptions.

As discussed above, actuarial standards should apply as broadly as possible. Accordingly, any new standards should not be in the form of a separate public plan actuarial standard of practice but rather should apply to all actuarial work in the pension area and, to the extent possible, to work on OPEB plans.

Thus any new guidance should be incorporated into existing ASOPs unless there is no relevant ASOP. There is at least one area where existing guidance is deficient – the assessment and disclosure of risk – and a new ASOP is needed.

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?*

   As discussed above, ASOPs should continue to be principles based and not rules based. However, they could be more prescriptive if done in a way that remains principles based. Also, it may be appropriate to be more prescriptive in the area of disclosures.

   Some of the current requirements in ASOP 41 are very prescriptive (for example the disclosures required when a prescribed assumption is used) and this is appropriate.

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?*

   Any additional standards should, to the extent possible, apply to all areas of practice in the pension community. It may be possible and appropriate for additional standards to apply in such a way that existing practice would not have to change for some areas, such as qualified plans in the private sector. But they should still apply.

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?*

CalPERS believes that pension administrators must perform their duties in a transparent manner and to the highest ethical standards[3]. Reflective of this belief in transparency, our actuarial valuation reports take a very broad view as to who is an intended user.

However, the decision as to what information is needed and most appropriate for the users of the reports should remain with the trustees of the retirement system. The ASOPs should not require significant additional work that is not requested by the principal even if that would provide useful information to individuals who are not intended users. Imposing such a requirement on actuaries would result in pension trusts paying for information that is not for the benefit of the beneficiaries of the trusts – a violation of trust principles.

There may be concern about ensuring that taxpayers have access to the information that they need to assess the financial condition of a retirement system or of possible impact of changes to the system. However, this is a basic misunderstanding of the situation. In the public sector, because of general application of freedom of information acts, it is relatively easy to obtain the information that is needed to perform such an independent valuation or cost estimate. So the underlying information is available. The question is who should pay for the work of converting the underlying information into the format that is desired by a particular stakeholder – the stakeholder or the members and beneficiaries of the retirement system?

Taxpayers have a way of getting this information that does not impose an unrecompensed burden on the trust. Taxpayers, either individually or (more realistically) via an association or via their elected representatives, can commission a review of the most recent actuarial valuation and/or an estimate of the cost impact of any proposed change. This is exactly what the California Department of Finance has done in the past. Similarly, if collective bargaining partners of the public employers wish to understand the potential impact of a change that they wish to propose, they can also commission an independent assessment.

In the private sector there are stakeholders who do not have an equivalent access to the information needed to make a reasonable assessment of the financial strength of a pension plan. These include members, shareholders and federal taxpayers (who provide financial support via the tax subsidy that qualified plans receive and who insure the benefits via the PBGC). If it is decided to impose requirements to provide information not requested by the principal, such requirements should apply to the private sector as well. In addition, the ASB should consider the application of such a requirement to all situations where actuarial work covers products with inherent tax subsidies.

[3] CalPERS has adopted a set of pension beliefs that includes the following: "Trustees, administrators and all other fiduciaries are accountable for their actions, and must transparently perform their duties to the highest ethical standards."

Conclusion

CalPERS believes that it would be appropriate to improve the Actuarial Standards of Practice applicable actuarial work in the retirement practice area but that any such changes should be applicable to all work in this practice area. More prescriptive standards would be appropriate in some areas so long as they remain based on principles rather than rules.

Improvements to Actuarial Standards of Practice along the lines outlined above should result in better actuarial work over time and be responsive to the needs of the public. They would also support and encourage strong and viable defined benefit pension plans and help meet the needs of America's workers for retirement security.

In closing, we wish to thank you again for this opportunity to provide input to on the subject of public pension funding and accounting. If you have questions regarding our opinions in this matter, please contact myself or CalPERS Chief Actuary, Alan Milligan.

Sincerely,

ALAN MILLIGAN
Chief Actuary