INTERNATIONAL ASSOCIATION OF FIRE FIGHTERS ®

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

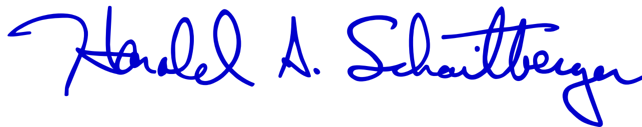
Conclusion

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,



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