

Cavanaugh Macdonald Consulting Statement of Proposed ASOP Revisions

The Actuarial Standards Board (ASB) has recently issued exposure drafts with proposed changes to three Actuarial Standards of Practice (ASOP) that are of interest to Cavanaugh Macdonald Consulting and many of our clients. The three ASOPs that have proposed revisions include ASOP 4: *Measuring Pension Obligations and Determining Pension Plan Costs or Contributions*, ASOP 27: *Selection of Economic Assumptions for Measuring Pension Obligations*, and ASOP 35: *Selection of Demographic and Other Noneconomic Assumptions for Measuring Pension Obligations*. Complete details and copies of the exposure drafts are available on the ASB website at www.actuarialstandardsboard.org.

Cavanaugh Macdonald Consulting has reviewed these proposed revisions and has identified some issues that we believe should be removed or modified prior to the adoption of the ASOP revisions. We expect to submit a formal response to the ASB ahead of the July 31, 2018 deadline.

One of the biggest concerns we have is with the proposed section 3.11 of ASOP 4. The section entitled "Investment Risk Defeasement Measure" calls for the inclusion in funding valuations of an amount necessary to effectively defease the investment risk of a pension plan. The language envisions a calculation whereby the benefits accrued as of the measurement are valued with a discount rate that reflects either U.S. Treasury yields or the rates at which pension obligations may be effectively settled.

There are several issues with presenting such a measure. First, this will create a situation where two measures of liability are presented in the same valuation report. Multiple measures (for different purposes) of the same liability is not a new concept in the pension world, but the results have typically been presented to corporate officers who have appropriate training and background to evaluate each measure in an appropriate context. We anticipate that for governmental plans who must present these reports to the public, there is potential for many citizens, not all of whom are as trained in financial matters as corporate officers, to be confused. Presenting such information may actually create a conflict with Precept 8 of the Code of Professional Conduct that applies to actuaries practicing in the United States. (Precept 8 states that an actuary shall take reasonable steps to ensure that such services are not used to mislead other parties.)

In addition, there are other concerns with the investment risk defeasement costs. Such a number is largely irrelevant for public plans. In many states, constitutional protections for public employees mean that the future benefit provisions cannot be reduced for an employee, so the value of a benefit accrued to date is little more than an interesting theoretical number. Because treasury bonds are only issued for a maximum period of 30 years, there is no true way to defease investment risk on benefit payments expected to be paid in 100 years. Thus, the measurement required by the proposed ASOP does not reflect anything that can actually be carried out in practice.

A second issue in the proposed ASOP 4 is the guidance on selecting amortization methods. Most notably, open amortization periods which have negative amortization (which would be expected for 20- or 30-year level percent of pay methods) is not acceptable under the ASOP. While section 3.14 applies "[i]f the actuary selects an amortization method," we are concerned that there may be challenges to the actuary's work even when the amortization method is set in state statute or by the retirement system board. Knowing that there are retirement systems with state-mandated open-20 year level percent

amortization methods that are over 95% funded, we do not believe it wise to automatically reject such an approach.

The third issue that we believe is noteworthy is the addition of section 3.20 defining a Reasonable Actuarially Determined Contribution. The specificity of this requirement goes beyond that usually provided in principal-based ASOPs. The requirement specifically excludes situations when the funding requirements are set in law. For many public plans, at least a portion of the factors determining the contribution determination are in law, even though the contribution determination itself may not be totally determined by law. This situation will need some clarification. There are also some situations in which a state commission or board may set the funding requirements for the public plans in the state. Because these requirements are not in law, but still binding, there is some confusion as to what should apply.

Cavanaugh Macdonald Consulting will continue to review these proposed changes and monitor developments. We anticipate preparing a formal comment on these changes and encourage others who are interested – actuaries or not – to review the proposals and consider offering their perspective and insights. The ASB explains how to comment at www.actuarialstandardsboard.org/current-exposure-drafts/. You may also contact your Cavanaugh Macdonald Consultant with any questions you may have.