## *STATE OF CALIFORNIA*

### *California Actuarial Advisory Panel*



Date

ASOP No. 4 Revision, Second Exposure Draft
Actuarial Standards Board
1850 M Street NW, Suite 300
Washington, DC 20036

**SUBJECT: ASB COMMENTS: ASOP No. 4, Second Exposure Draft**

The California Actuarial Advisory Panel (CAAP) supports the ongoing improvement of Actuarial Standards of Practice (ASOPs) and appreciates the opportunity to provide input to the Actuarial Standard Board (ASB) on the second exposure draft for proposed ASOP No. 4 changes.

The CAAP was created with the passage of California Senate Bill 1123 in 2008 and consists of eight public sector actuaries appointed by public officeholders and agencies. Pursuant to California Government Code section 7507.2(2):

> "… the panel shall provide impartial and independent information on pensions, other post-employment benefits, and best practices to public agencies…."

As members of the CAAP, our background is in public plans, and many of our comments are made from that perspective.

Our comments are divided into sections corresponding to the Second Exposure Draft.

**§3.11 – Low-Default-Risk Obligation Measure (LDROM)**

1. We believe the LDROM is much more appropriately covered by ASOP No. 51 (Assessment and Disclosure of Risk Associated with Measuring Pension Obligations and Determining Pension Plan Contributions). We made this point in our comment letter for the first disclosure draft but it seems more obvious now that the word "Risk" is part of the LDROM. ASOP No. 51 has been in force for less than two years and encourage the ASB to give ASOP No. 51 time to be fully implemented.



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We believe it is redundant and overly prescriptive to add a mandatory requirement to ASOP No. 4 like the LDROM.

We note the Pension Committee of the ASB (rightly) pointed out that to show the investment risk cost, there must be a comparison made to an actuarial present value computed as part of the funding valuation, i.e. a present value from the valuation that is computed using a discount rate which reflects the expected rate of return on plan assets. The LDROM does not take that approach.

For the above reasons we strongly urge the ASB change the recommendation of the LDROM from "should" to "should consider".

2. We agree with allowing use of any immediate gain actuarial cost method in complying with §3.11 and appreciate that the ASB incorporated this appropriate additional flexibility. However, in the first paragraph of § 3.11, the LDROM is described as an "obligation measure of *benefits earned* as of the measurement date" [emphasis added]. That description is inconsistent with the fact that some immediate gain methods do not measure the value of benefits earned but rather measure the value of costs accrued under some cost allocation methods (like Entry Age Normal). For that reason, the words "benefits earned" should be changed to "benefits earned or costs accrued". Furthermore, as discussed in our next comment, the word "obligation" should be deleted in this sentence, leaving "… a low-default-risk measure of the benefits earned or costs accrued as of the measurement date."

3. As to the name of this measure, consistent with our previous comment, we recommend removing the term obligation, changing the name to Low-Default-Risk Measure (LDRM). When referring to a specific, quantified measure "obligation" generally refers to a present value of some form of accrued benefit, whether based on current salaries or projected salaries (as in the accounting measures ABO and PBO). In contrast, as discussed just above, LDROM can be based on any immediate gain method, and so can measure the value of either accrued benefits or accrued costs. Removing the word "obligation" from the name of this measure and so using the more general term "Low-Default-Risk Measure" removes the possible inference or presumption that this value necessarily measures accrued benefits.

   As a less preferred alternative, you could add the word "Pension", thereby changing the name to Low-Default-Risk Pension Obligation Measure (LDRPOM). This would be consistent with how the word "obligation" is used both in the title of ASOP No. 4 and throughout its text, where "obligation" is used with "pension" as a modifier. We believe this makes clearer that in

ASOP 4 "pension obligation" refers generally to the pension benefit offered by the plan, rather than to a particular type of measure applied to that benefit.

4. The second paragraph, first sentence, of §3.11 should be changed from "...pattern of benefits…" to "…pattern and amount of benefits…" (additional wording highlighted for emphasis). Furthermore this paragraph should also have a sentence that says "The actuary should not xxx these two things when selecting the discount rate." These two changes will make this paragraph consistent with our understanding of how the appropriate discount rate would be selected.

5. We agree with including discount rate alternatives and appreciate the ASB showing options.

6. We agree with the use of immediate gain actuarial cost method in §3.11.

**§3.14 – Amortization Method**

We appreciate and agree with the changes to §3.14, in particular the reference to amortization bases.

**§3.16 – Output Smoothing Method**

We appreciate and agree with the changes to §3.16.

**§3.19 – Implications of Contribution Allocation Procedure or Funding Policy**

We suggest changing the 3rd sentence in the first paragraph from:

> "If the **contribution allocation procedure** results in an **actuarially determined contribution** that is less than the **normal cost** plus interest on the unfunded **actuarial accrued liability**, the actuary should estimate how long before the **actuarially determined contribution** is…"

to:

> "If the **contribution allocation procedure** results in a~~n~~ ~~**actuarially determined**~~ contribution that is less than the **normal cost** plus interest on the unfunded **actuarial accrued liability**, the actuary should estimate how long before the ~~**actuarially determined**~~ contribution is…" (Additional wording highlighted for emphasis and deleted items set in ~~red lined~~ font).

This change makes this sentence consistent with the section's title and the remainder of the section

Thank you for considering our responses and please do not hesitate to contact us if you have any questions.

Sincerely,

Paul Angelo
Chair, California Actuarial Advisory Panel

cc: Panel members
John Bartel, Vice Chair
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