August 26, 2014

Director of Research and Technical Activities
Project No. 34 – 1NTP
Governmental Accounting Standards Board
401 Merritt 7, PO Box 5116
Norwalk, CT 06856-5116

To: Director of Research and Technical Activities, Project No. 34 – 1NTP

These comments are in response to the request for written comments on the Governmental Accounting Standard Board (GASB) Exposure Drafts — ACCOUNTING AND FINANCIAL REPORTING FOR PENSIONS AND FINANCIAL REPORTING FOR PENSION PLANS THAT ARE NOT ADMINISTERED THROUGH TRUSTS THAT MEET SPECIFIED CRITERIA, AND AMENDMENTS TO CERTAIN PROVISIONS OF GASB STATEMENTS 67 AND 68. The following comments were developed through the coordinated efforts of members of the Conference of Consulting Actuaries’ (CCA) Public Plans Community and are being submitted to the GASB by the Steering Committee of the CCA Public Plans Community. However, these comments do not necessarily reflect the views of the CCA Board, the CCA’s other members, or any employers of CCA members, and should not be construed as being endorsed by any of the aforementioned parties.

The CCA Public Plans Community (PPC) represents a broad cross section of public-sector actuaries whose extensive experience with public plans provides the framework for our response. The PPC includes over 50 leading actuaries whose firms are responsible for the actuarial services provided to the majority of public-sector retirement systems. Our membership includes a diversity of opinions and perspectives on public pension plan valuation issues, such that not all of our community, necessarily, subscribe fully to all the comments presented here. Nonetheless we believe the overall response reflects a substantial consensus among the actuaries who provide valuation and consulting services to public pension plans.

We are grateful to the GASB and project staff for their hard work in striving to understand these complicated and interconnected issues.

Paul Angelo, FSA, FCA, MAAA, EA (By Direction)
Chair of the Public Plans Steering Committee on behalf of the Public Plans Steering Committee
Response to the (GASB) Exposure draft
ACCOUNTING AND FINANCIAL REPORTING FOR PENSIONS AND FINANCIAL REPORTING FOR PENSION PLANS THAT ARE NOT ADMINISTERED THROUGH TRUSTS THAT MEET SPECIFIED CRITERIA, AND AMENDMENTS TO CERTAIN PROVISIONS OF GASB STATEMENTS 67 AND 68

The bulk of the Exposure Draft covers pension plans that are not funded through a trust and a small portion (Paragraphs 94-99) covers “funded” plans that are already covered by GASB 67 and 68. We have some comments about each of those sections.

Current Issues and Practices regarding “pay-as-you-go” plans

The majority of plans covered by paragraphs prior to 94 are often referred to by actuaries as “pay-as-you-go” plans. While there are a variety of plans that could fall into this category we find three common situations, each of which is described in some detail below.

IRC §415 and §401(a)(17) Excess Plans – IRS has limits on benefits (§415) and pay (§401(a)(17)) that apply to benefits under qualified plans. For example, a college president might have a $500,000 annual salary but only $260,000 can be used to determine their “qualified” pension. A small percentage of members reach these limits and in some cases the employer establishes a non-qualified “Excess” plan to provide the benefits curtailed by these limits. Such benefits must be paid to affected retirees from funds outside of the qualified plan, often on a pay-as-you-go basis for the reasons described below.

Length of Service Award Programs (LOSAPs) for volunteer firefighters – Defined benefit LOSAP plans tend to provide small, often not pay-related benefits (e.g. $10/month per year of volunteer service) in part due to IRC 457 limits. Many LOSAP plans are funded and covered by GASB 67 and 68. However, a certain number are not pre-funded possibly due to the fact that many were started by the volunteers and not the local governments. However, most now have a local government paying these benefits.

Old Closed plans – There are a number of small plans that have been closed to new members for decades. Many of these plans are composed exclusively of very old retirees and beneficiaries. Generally they represent a relatively small obligation to the employer.

Regardless of which of these three types of plans an employer may sponsor, we believe that the proposed rules should apply (subject to first two numbered comments listed below). However, we believe it would be helpful to provide some background information about the funding of the Excess Plans in particular, so that the GASB Board has a better understanding of both current practice and our internal discussions.

Prior to some specific points in the past (1990 and 1996 being two key dates), the §415 benefit limits and the §401(a)(17) pay limits were either not applicable or even less significant. It was common practice to fund pension funds ignoring the §415 or §401(a)(17) limits when determining the employer contributions. When the limits became more of a factor, some but not all employers established a separate Excess Plan. However, prefunding an Excess Plan can create substantial administrative problems. A good example would be a multiple employer plan where some and not all employers have members reaching the limits. Often employers only had one or a small number of people getting excess benefits (if any). When an “Excess” benefit retiree dies, any reserve accumulated in an Excess plan would often have no further use and might need to be returned to the employer. For this and other reasons (some historical) the following practice became common:

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1. The qualified plan liability and its Actuarially Determined Contribution (ADC) are determined without regard to the limits.

2. The individual Employers fund the full ADC but only the difference between the gross ADC and the employer specific pay-as-you-go cost for the Excess Plan is contributed to the qualified plan. In other words, the ADC based contributions to the qualified plan are reduced by the current benefits payable under the Excess Plan.

3. The remaining contributions are used to pay benefits under the Excess Plan, which are paid directly to the retiree by the employer or their agent (often the same retirement system handles both plans).

Our CCA group discussed the possibility of asking GASB to allow the reporting on a combined basis using GASB 67 and GASB 68 rules. However, we decided not to. Even though the Excess plan may be a very small part of the total, it is a separate plan. This will mean financial reporting of a (Total) Pension Liability for the qualified plan that is smaller than the actuarial accrued liability in the funding valuation.

We believe that the determination of a gross contribution determined without regard to the limits is an appropriate funding method. However, the proposed accounting rules may lead to separate funding of the two plans, which would also be an acceptable practice.

We would also encourage plans to discuss this with their auditors to see if the situation is immaterial enough to avoid separate accounting.

Comments on the Exposure Draft

The following are our five recommended changes to the exposure draft.

1. Ten Year Benefit Projection

Paragraph 41(c) of the ED requires governments that determine an Actuarially Determined Contribution (ADC) to provide a 10 year schedule comparing the actuarial contributions to the ADC in the RSI. Occasionally pension plans pay benefit payments from general revenue (this approach is sometimes called pay-go funding), with perhaps additional ad hoc payments to an irrevocable trust depending upon the availability of funds. An ADC is expected to stay relatively stable as a percentage of pay. In contrast, benefit payments might be expected to increase rapidly due to an anticipated increase in retirements. Accordingly for local governments that do not determine an ADC, we suggest the standard require disclosure of a schedule showing the benefit payments for current members and other trust contributions in separate columns for the last five years, together with a projection of the expected benefit payments over the next 10 years, both in dollars and as a percentage of payroll so that users of the financial statements can gauge the impact of the pension program on the government’s finances. We do not recommend disclosure more than 10 years into the future because the projections do not include the impact of future hires and so may understate future benefit payments.

2. More Guidance on Treatment of Assets in Paragraphs 14, 92 and 93 (and appendices B18 and 19)

We realize that there may be assets set aside for these liabilities that do not qualify to be considered when determining a Net Pension Liability. It is not clear how/where these assets are to be shown on the employer’s financial statement. For example, could they be shown as an Internal Service Fund or a Fiduciary Fund? When are they “restricted assets” and when are they “committed assets”? We understand that GASB 54 may be relevant here. Please consider whether more instruction or guidance is needed on how these assets are classified. While these are clearly accounting issues and not actuarial issues, actuaries are sometimes asked these kinds of questions and it is helpful if we have more guidance to assist the accountants in deciding the appropriate treatment.

3. Discount Rate for Plans When Assets Do Not Meet Criteria of paragraph 4

When assets are set aside for these liabilities that do not qualify to be considered when determining a Net Pension Liability the Board may want to consider allowing the long term expected return on these assets to be used to determine the discount rate provided there has been an established historical pattern of not using such assets for any purpose other than to pay plan benefits or allowable expense.
4. Comment related to reporting for funded plans: Limit anticipation of large contribution increases when determining the blended discount rate

We noted that the Exposure Draft included some changes impacting the reporting for funded pension plans. We are proposing that GASB incorporate the following concept into addition to paragraphs 94-99 covering funded plans to allow for parallel treatment with the proposed OPEB rules.

The discount rate required by GASB 67/68 and the proposed OPEB standard reflects the long-term expected rate of return on Pension/OPEB plan investments that are expected to be used to finance the payment of benefits, to the extent that the plan's fiduciary net position is projected to be sufficient to make projected benefit payments and plan assets are expected to be invested using a strategy to achieve that return. We are concerned that, with regard to the inclusion of future contributions, the projection of the sufficiency of plan assets may be too permissive. This is an area that could create confusion and also encourage wide variations in practice and potential abuse. While the need for this proposed change is greater for OPEB plans, we suggest our proposal (described below) apply to both the new OPEB standard and the existing GASB 67/68 standard (as an addition to the Pension Exposure draft that was issued at the same time as the OPEB Exposure drafts).

Why is there an issue? Many OPEB plans have low funding levels (e.g. 5% to 30%) but, of course, the blended discount rate is not based on the current funded percentage. Many employers are ramping up OPEB funding to reach the full Actuarially Determined Contribution (ADC) amount but some others are funding little if any above the pay-as-you-go cost. It is possible to show that a crossover date can be avoided thereby allowing the proposed GASB discount rate to equal the expected return on assets in the trust if (1) an OPEB plan has a small amount of funds in a trust, (2) the employer is contributing pay-as-you-go cost and (3) the employer is not fully funding the ADC in the term near future. This can occur even though the pay-as-you-go cost might be projected to increase rapidly (in percentage terms even more rapidly than payroll). This implies an added contribution burden in the future that may or may not be realized but nonetheless can be used to support the higher discount rate and thus a lower the Net OPEB (or Pension) Liability.

Our basic proposal is that the projected contribution amount should not be allowed to be assumed to increase at a rate faster than payroll unless the employer is contributing the Actuarially Determined Contribution (ADC). The ADC rule is to allow for some level of faster-than-payroll contribution increases for predictable and policy based contribution increases due to assets smoothing (when smoothed value is greater than market value) or to the use of the Projected Unit Credit funding method).

5. Treatment of DROP: Exit Age/End of Normal Cost

GASB 67/68 call for the use of the Entry Age Normal Cost method. The proposed OPEB rules would provide a different age at which Normal Cost starts and stops under the Entry Age method when a pension plan provides a DROP.

DROPs are pension provisions (that most often provide more valuable benefits than if a member continued to work without electing to DROP) and not OPEB provisions. An employee in DROP is going to be covered by active member health insurance and not retiree health benefits. We believe that the proposed OPEB attribution rule should be over the entire working career as proposed and should end when active medical ends and retiree medical begins. It should not end while an employee is working, receiving active medical and in a pension DROP. However, we also believe that the GASB 67/68 rules should be amended to match the proposed OPEB rules. We believe that the attribution rule-period should be over the entire working career and not end while an employee is both working and in a pension DROP (earning an additional lump sum benefit). We would like you to revisit GASB 67/68 in this area.

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2 Few pension plans are funded this low so this is less of an issue for pensions.
CCA comments for Public hearings September 10, 2014, at Courtyard by Marriott LaGuardia Airport Hotel, 90-10 Grand Central Parkway, Queens, NY

(also see 34-1NTP comment letter #12 and 34-1E comment letter #54)

My name is Tom Lowman. I am an actuary and here today to discuss the comments of the Steering Committee of the Conference of Consulting Actuaries Public Plan Community. I’ll just refer to us as the CCA.

The CCA submitted a letter on the Pension Exposure draft and helped the American Academy of Actuaries (the Academy) write their OPEB comment letter. I’ll start with the CCA Pension letter.

The CCA letter is a combination of education on some issues and recommendations. The first item is education on three of the most common types of pension plans that often fit into this category of unfunded plans. One type in particular is the “non qualified” plans providing benefits above the level allowed by the IRS for “qualified” plans. Often Actuarially Determined Contributions (ADC) are determined on a combined basis - meaning including benefits above the IRS limits. At the same time, these excess benefits are not paid out of qualified plan assets. Our comments on this topic are educational in nature since we concluded that the GASB approach of treating these as separate plans is appropriate. The need for education is in part to have sponsors think about how these plans are funded (or not funded) and whether the ADC should be separated. Please see our letter for more details.

The second pension issue is one that is parallel to the recommendations you will see in the Academy letter on unfunded OPEBs. When employers are not contributing the ADC we think it is important to disclose a “closed group” 10-year benefit projection.

Our letter is also one of several in which you are asked to consider providing more direction on when assets not in a trust are “restricted assets” and when are they “committed assets”. If you think the accountants already know, that is great but often they ask the actuaries about what these rules mean.

There are some situations where assets might be invested like traditional pension trust funds (i.e. in stocks and bonds) but do not count as trust assets. We would like some clarity as to what this means when setting the discount rate for benefits paid from these funds which are expected to produce returns above the 20-year bond rate.

As you know, the ED covered some issues impacting GASB 67 and 68 for funded plans. We have two suggestions about funded plans.

- First is one that is parallel to the recommendations you will see in the Academy letter on unfunded OPEBs. Our basic proposal is that the projected contribution used to determine the cross over point for determining the discount rate not be allowed to be assumed to increase at a rate faster than payroll unless the employer is contributing the Actuarially Determined Contribution (ADC). The Academy provided two additional options but we stayed with just the one tied to payroll growth.
The Second is about the attribution period which to an actuary means when the normal cost starts and stops. We think this should be over the entire working career and should not end when they join DROP. This end date would be consistent with your OPEB proposal.

This takes me to your OPEB EDs. The CCA volunteers created a list of topics and worked with the Academy to create the Academy comment letter. We were supportive of the “Areas of Comment” that were contained in the Academy letter and saw no reason to write a separate letter from CCA. However, there were some things that fell to the cutting room floor that I will at least mention.

I know that you received some opposing letters saying the OPEB liabilities should or should not be on the balance sheet. Related to this is the varying firmness of the benefit promise and the understandable desire by GASB to have a single rule. What is missing is a requirement by the governments to tell the users of the statements what the government’s ability is to modify or eliminate a benefit. This is not an actuarial issue but one the Board should consider.

For plans with a DROP, the Academy letter does not talk about OPEB normal cost ending when you leave DROP since the ED as written has this as the rule, and we believe it is correct. I also covered this issue previously in my earlier comments on the Pension ED.

Finally there is the issue of the Cross Employer Subsidy. We understand that this issue does not impact most OPEB plans. Generally, actuaries project the future OPEB benefits partly by looking at recent claims, ignoring any active employee subsidies and adjusting rates by age. However, sometimes there is a pooling arrangement where some employers end up subsidizing other employers in a zero sum situation. The question we asked was whether this real cross subsidy should be taken into account in our projections. We had three choices:

1. Say yes and tell GASB to change the ED and create a need to deviate from ASOP 6. Neither the CCA nor the Academy was willing to do this.
2. Say nothing and the cross employer subsidy would not be factored in since the ASOP 6 rule would apply. There was pressure to do this.
3. Say something of an educational nature, which is what was settled upon by the Academy and the CCA would have done the same.

The Academy and others, including John Bartel, will talk to you more about this. However, there was one good example from the CCA/Academy discussion that ended up on the cutting floor which John Bartel has reworked and will discuss at a later hearing. This educational information is important since some plan sponsors and actuaries think the ASOP’s got this wrong and it is not consistent with the treatment in cost sharing plans. However, it really gets to the issue of whether we are valuing the benefit promised or the expected cost to provide the promise since here they are not the same.

Concerns over “assessment spirals” are also factors in this discussion but my 10 minutes are about up.