August 29, 2014

Director of Research and Technical Activities
Project No. 34-1E and 34-1P
407 Merritt 7
P.O. Box 5116
Norwalk, CT 06856-5116

Re: Exposure Drafts on Non-trust Pensions

Dear Director, Staff and Board Members:

Thank you for the opportunity to share some brief thoughts about the GASB’s recent Exposure Drafts (ED) relating to 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. And thank you for all the hard work you all do for the public.

While I am active in various actuarial committees of the Conference of Consulting Actuaries and the American Academy of Actuaries and active providing actuarial consulting to clients of my employer (Gabriel, Roeder, Smith & Company), my comments below are my own and should not be understood as representing the opinions of those organization.

1. Formatting and Structural Organization of the Statement – Needs an overhaul

   Please refer to my comment letter on the OPEB EDs. Similar comments are applicable to this non-trust pension ED as well.

Since you opened the non-trust pension ED to amendments to GASB Statement Nos. 67 and 68, consider the following for comments/suggestions for additional amendments to Statement No. 67 and 68.

2. Implicit discount rate for gain-sharing benefits – Require explicit projection using modelling

   Some plans have provisions that grant post-retirement benefits in the form of a 13th check or a one-time permanent benefit increase. These increases are triggered whenever investment returns exceed a given level. There are numerous variations on this theme. Let’s presume for discussion that it has been determined that they are either automatic or substantively automatic, so that they should be included in the projection of future benefits.

   Some plans and their actuaries have approximated the added cost of this probabilistic and non-symmetric benefit provision by simply reducing the otherwise long-term expected rate of return by X basis points,
and proceeding along with the lower return assumption as if, in every way, it is the new long-term expected rate of return, including reporting it as such in the plan reporting required under GASB Statement No. 67. Consider a plan that expects the long-term expected rate of return on its assets to be 8.5% (clearly on the high side), but reduces that by 75 basis points for gain-sharing and treats 7.75% as the long-term expected rate of return in all the GASB-required calculations. How they might have come up with the 75 basis points is another whole discussion.

This is commonly referred to an *implicit* approach to recognizing the cost of gain-sharing. An *explicit* approach would be model the gain-sharing provisions and estimate the single equivalent annual cost of living increase; then value that as part of the plan.

The pension standards do not expressly address this method, and it is not expressly prohibited in the ASOPs. However, I believe it is not what the Board would expect for faithful compliance with the standards for two reasons:

a. *It is what it is.* When the pension accounting standards speak of the long-term expected rate of return, the only adjustment to that is for investment-related expenses. When the long-term expected rate of return on plan assets is reported in the note disclosures, it should be just that – the long-term expected rate of return on plan assets (net of investment related expenses).

   To report otherwise undermines comparability and the essential understanding of the liability. It also undermines transparency. It is a way to disguise an aggressively high return assumption and make it look like its return assumption is more mainstream.

b. *No projection of benefits.* Paragraph 39 of GASB Statement No. 67 states:

   39. Projected benefit payments should include all benefits to be provided to current active and inactive plan members through the pension plan in accordance with the benefit terms and any additional legal agreements to provide benefits that are in force at the pension plan’s fiscal year-end. Projected benefit payments should include the effects of automatic postemployment benefit changes, including automatic COLAs. In addition, projected benefit payments should include the effects of (a) projected ad hoc postemployment benefit changes, including ad hoc COLAs, to the extent that they are considered to be substantively automatic; (b) projected salary changes (in circumstances in which the pension formula incorporates future compensation levels); and (c) projected service credits (both in determining a plan member’s probable eligibility for benefits and in the projection of benefit payments in circumstances in which the pension formula incorporates years of service).

   Furthermore, the discount rate determination requires the projection of benefit.

   However, the implicit approach does not project the gain-sharing benefits as any other benefit; does not then discount them along with discounting other plan benefits; and does not then allocate them to periods of service as other benefits are.

It will take a more definitive statement from the GASB to move plans toward an explicit approach to measuring the cost of gain-sharing. To make matters worse, gain-sharing provisions have been among the more opaque and previously unrecognized costs and liabilities of governments. Finally, it is too easy to back into the needed long-term expected rate of return to make the arithmetic work out.

I am requesting the Board and Staff use whatever vehicle is most appropriate to bring more discipline, comparability and transparency to the measurement of this type of benefit.
3. Guidance in Actuarial Standards of Practice (ASOPs)

My comments and request in the other comment letter relating to “guidance in” the Actuarial Standards of Practice are applicable to GASB Statement Nos. 67 and 68, if you are willing to open the door a bit wider. Please refer to that comment letter.

Again, thank you for this opportunity and for all your hard work. I am available to discuss any aspect of this comment letter or otherwise, or to pursue additional research alone or in conjunction with my involvement with any of aforementioned organizations.

Sincerely,

James J. Rizzo, ASA, MAAA