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: Plan and Employer Exposure Drafts on Other Postemployment Benefits (OPEB)

Dear Director, Staff and Board Members:

Thank you for the opportunity to share some thoughts about the GASB’s recent Exposure Drafts (EDs) relating to Financial Reporting for Postemployment Benefit Plans Other Than Pension Plans and Accounting and Financial Reporting for Postemployment Benefits Other Than Pensions. 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 organizations.

1. Guidance in Actuarial Standards of Practice (ASOPs)

   The two OPEB Exposure Drafts refer to the Actuarial Standards of Practice in a number of ways:
   a. “in conformity with the Actuarial Standards of Practice”
   b. “in accordance with the Actuarial Standards of Practice”
   c. “this Statement requires that Actuarial Standards of Practice be applied”
   d. “the broad guidance in the Actuarial Standards of Practice”
   e. “when Actuarial Standards of Practice are applied”
   f. “to the extent permitted by actuarial standards of practice”

   The Actuarial Standards of Practice (ASOP) No. 1 states that failure to follow a “should” statement in any of the ASOPs constitutes a deviation from the guidance. “Deviation” is defined in ASOP No. 1 as “The act of departing from the guidance of an ASOP.” When a deviation has occurred, it is necessary for the actuary to disclose the deviation in order for the actuarial communication to remain in compliance with the ASOP. Once the deviation has been disclosed in the actuarial communication, the actuary has performed his or her work “in accordance with” the ASOPs or “in conformity with” the ASOPs.

   I do not believe this is what the GASB intends for actuarial assumptions and measurements that subsequently find their way into government accounting and financial reporting. Preparers rely upon the actuarial assumptions and measurements found in actuarial communications sent to the client.
Deviating from the ASOPs and disclosing the deviation in the original actuarial communication to the client would open door for loopholes in chain of compliance desired by the GASB. I believe the GASB does not want to set the bar so low that the actuarial results are merely “in accordance with the ASOPs” or merely “in conformity with the ASOPs”. I believe the GASB wants the actuarial assumptions and methods to be “in conformity with or in accordance with the guidance in the Actuarial Standards of Practice issued by the Actuarial Standards Board.” The absence of the reference to the guidance in the ASOPs is inconsistent with the GASB’s intent to rely upon the Actuarial Standards of Practice for comfort in its accounting standards-setting process.

In the world of actuarial standards-setting, this is not a mere preference in wording or nit-picking. Following the guidance in the ASOPs is a core issue with the Actuarial Standards Board. It is also a core issue with the Actuarial Board for Counseling and Discipline.

Therefore, I recommend that the GASB direct the Staff to adjust the wording in each relevant reference to the Actuarial Standards of Practice in the OPEB Exposure Drafts so as to refer to “the guidance in the Actuarial Standards of Practice issued by the Actuarial Standards Board.” The following underlined additions to each reference cited above would constitute an important technical improvement to the Standard:

- “in conformity with the guidance in the Actuarial Standards of Practice”
- “in accordance with the guidance in the Actuarial Standards of Practice”
- “this Statement requires that the guidance in the Actuarial Standards of Practice be applied”
- “the broad guidance in the Actuarial Standards of Practice”
- “when the guidance in the Actuarial Standards of Practice are applied”
- “to the extent permitted by the guidance in the actuarial standards of practice”

2. **Discount Rate Topic A – Measurement Attribute**

This topic relates to the discounting of benefits using the long-term expected rate of return in cases when there is no cross-over date or for those benefits payable prior to the cross-over date.

In GASB Statement Nos. 67, 68 and these two OPEB EDs, the Board considered but rejected the market (or fair) value of liability for pension and OPEB obligations; and did so for sound financial reporting reasons rooted in a best estimate or expected long-term cost of services to taxpayers.

The Board recognized that the measurement of the taxpayers’ liability for pensions should take into account the ability for the pension fund to reduce the actual cost to taxpayers. It does this by accumulating sufficient assets to generate investment income that substantially reduces the cost to taxpayers. As long as a pension plan is not in imminent likelihood of settling in a single sum with a third party, its liability should be measured as a best estimate or expected long-term cost of services to taxpayers. Setting aside the matter of a cross-over date until the later discussion of Discount Rate Topic B, and assuming the accumulation of substantial assets invested accordingly, the two pension standards and these two EDs accept a discount rate equal to the long-term expected rate of return as reflective of the fund’s ability over time to reduce the cost to taxpayers. The Board also recognized the career-long exchange between employer and employee. These principles informed the Board when it set the standards on how to measure the liability.

Concept Statement No. 6 defined the settlement value in two ways, for application at the discretion and judgment of the GASB for standards-setting purposes. Paragraph 42 states, in part:

> A settlement amount can be either (a) the amount that the counterparty would accept to settle the liability or would pay to satisfy a receivable at the measurement date or (b) the amount that will be
realized from an asset or will be needed to liquidate the liability in due course according to the
terms of the arrangement between the government and the counterparty.

Paragraph 42(b) is the basis for what the Board had done in adopting GASB 67 and 68. This definition
of settlement value speaks exactly to how pension and OPEB plans (those that are actuarially pre-
funded) settle their obligations – a little at a time over a long period of time with the help of substantial
investment earnings generated over time by a build-up of assets dedicated to that purpose.

In the historical timetable, CS 6 was being deliberated concurrently with GASB 67 and 68. When GASB
67 and 68 were adopted, CS 6 was still in deliberation; thus GASB 67 and 68 could not add Basis of
Conclusion paragraphs that refer to this paragraph 42(b). It would have been the natural thing for a Basis
of Conclusion paragraph to describe how the measurement attribute selected by the Board is informed by
a particular Concept Statement. In fact, GASB 67 and 68 do not even refer to measurement attributes. I
understand why that was not possible for GASB 67 and 68, because CS 6 had not yet been adopted.
However, it has now been adopted.

Please refer to my comment letter (attached) sent last September to the GASB in response to the
exposure draft for the Measurement of Elements of Financial Statements, later to become Concept
Statement No. 6.

It would be helpful to all who read the new OPEB standards that result from these two EDS for the
Board to document its purpose for selecting the particular measurement attribute in the Basis for
Conclusions in the new OPEB standard.

Therefore, to settle the matter, I ask that the Board direct Staff to include a paragraph in the new OPEB
standards that refer to paragraph 42(b) of CS 6 in support of the Board’s decision to discount benefits
payable prior to any cross-over date using the long-term expected rate of return.

I understand that the Board might not want to go back to amend the Basis for Conclusions in GASB 67
and 68 and include, for the record, the basis for its measurement attribute as rooted in what is now
paragraph 42(b).

However, you can do that now for the two new OPEB standards.

3. **Discount Rate Topic B** – A More Stabilized Muni Rate

Would you consider changing the reference to the muni rate so that it is no longer the yield on a
particular day? I suggest that the muni rate we are to use remain the same for several years at a time in
order to stabilize the discount rate. Here’s one idea: The Staff and Board could establish a procedure to
publish Technical Bulletins whenever research of muni indices indicates a sufficient change in rates and
when it appears it may remain stable for a while; the exact criterion is not as important to me as the end
result – stability of our discount rates. There are three anomalies that occur under the current approach
that might cause the Board to reconsider.

Consider a non-trust\(^1\) single-employer OPEB plan.

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\(^1\) These are far more common than pre-funded OPEB plans. I am using the term “non-trust” Pension and “non-trust”
OPEB as a short-hand way to referring to a plan that is pay-as-you-go, with no advance accumulation of any assets. In
other references I might use it to describe a plan that does accumulate assets but not in a vehicle that satisfies paragraph
4 of the employer OPEB ED.
a. **Comparability** is impaired between employers with reporting dates or measurement dates that fall on June 30 and those that fall on September 30 solely due to the change in the reference yields; certain years have seen yields during that three-month period change significantly. Researchers and other users tend to compare entities’ financial statements of a given calendar year with each other. Stabilizing the discount rate over a period of years will enhance comparability without sacrificing faithfulness to the measurement concepts.

b. **Artificial volatility** is created for any single employer from year to year, when the underlying obligation has not changed. I recognize that the measurement approach is to re-measure the liability (whether pension or OPEB) because the moving parts have changed since the prior measurement – new members joined, old members exited, some retired, per capita cost changed from expected; in other words, actual experience differed from expected, so re-measurement is required. However, the yield on municipal bonds has no bearing upon the underlying obligation – it is just a handy way of reducing things to present values – consistent with other calculations in financial reporting that require discounting. Stabilizing the discount rate over a period of years will enhance reliability by keeping the re-measurement moored to the same discount rate for a period of years.

c. **Comparability** is also impaired by leaving too much freedom to select a reference index. There are several different indices (Bonds Online, Yahoo Finance, FMS Bonds, Bond Buyer, etc.) that seem to satisfy the description, but which produce varying yields as of a given date. One randomly selected observation shows a 50-bp spread between AA and AA A for one particular index, and a 56-bp spread between one AA index and another AA index. If the GASB would issue a Technical Bulletins or some other vehicle to announce the muni yield to use for discounting over the following five years, it would enhance comparability, particularly for unfunded OPEBs.

My main objection of the current method is that it forces a change in the value of the liability even if the underlying promise has not changed; the value changes only because of a change in external, non-relevant economic conditions.

To stay more consistent with paragraph 42(b) of Concept Statement No. 6, it would be better to fix the discount rate at some average or stabilized yield (over say 5-year periods) on 20-year, tax-exempt general obligation municipal bonds with an average rating of AA/Aa or higher.

This could very well apply to GASB 67 and 68 if the Board desired to make them consistent with this suggestion.

4. **Discount Rate Topic C** – Inappropriate reliance on a long-term expected rate of return

The basis for using a long-term expected rate of return in discounting expected benefit streams and attributing the costs to years of service presumes a build-up of substantial assets which would be expected generate substantial investment earnings to help finance the benefits. This is the intent and the funding policy for most pension funds which, generally speaking, use cumulative investment earnings to pay a large portion (some say 80%) of the benefits payable. That is why it was appropriate for the GASB to take into account the long-term expected rate of return to discount the expected benefit stream. The effectiveness of the pension or OPEB fund to generate investment earnings over time reduces the

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2 For the purpose of this discussion, I will presume an investment asset allocation of approximately 70% in equities (possibly including real estate and alternatives) and 30% in fixed income instruments together with a given level of investment-related expenses, so that a reasonable geometric compound expected return over time is approximately 7% net. This expectation can be achieved even with a very small corpus, invested in index funds.
cost to taxpayers, and that should be recognized in measuring the balance sheet liability which taxpayers are expected to pay.

However, some trust-funded OPEB plans do not have a funding policy that is expected to build up substantial assets. This is a phenomenon that occurs in OPEBs more than pensions. An employer can establish a funding policy, either deliberately or merely arising de facto, that does not build up substantial assets – but does build up enough to avoid a cross-over date and discount the expected benefit stream at an expected long-term rate of return, e.g., 7%.

A worst case scenario is a funding policy under which the employer contributes 1.25% of the first year’s expected benefits and 1.01% of each year’s expected benefits thereafter into a qualifying trust fund. The trust always has enough to pay the benefits and the balance remaining is invested 70/30 to earn an expected 7% over time. But the corpus of the fund is so small that it will never build up substantial assets and will never generate substantial investment earnings to help pay the benefits in any large measure. Essentially, the pay-as-you-go employer contributions transferred from its own assets finances the benefits.

This is not what was intended when the single equivalent discount rate algorithm was developed by the GASB in the context of a reasonably funded pension plan. Even if the pension plan hits a cross-over date sometime out in the future due to an inadequate funding policy, at it would have built up substantial assets prior to the cross-over date under a more reasonable funding policy.

Other examples can be constructed that illustrate the same problem. This is not just an academic problem; and would apply to far more OPEBs than pensions. And the funding policies that are in place that give rise to this are not necessarily nefariously constructed. De facto funding policies (such as: make a contribution whenever you have a surplus) in place over the previous five years as considered with professional judgment just turn out this way.

Just appealing to the use of professional judgment may not be sufficient to close the loophole.

I thought some solutions to this that the Board could consider. Some seemed were too prescriptive for your purposes, and others solved only a narrow set of circumstances. There are so many different patterns of expected future employer contributions, patterns of asset build-up or drop-off and funding policies, that specific prescriptive solutions did not seem to solve the wide range of circumstances.

The best prescriptive approach that I could think of, would be to require the internal asset build-up to reach at least 10 times the expected benefits for any given future year during the time prior to any cross-over date, before being allowed to use the expected long-term rate of return for that period prior to a cross-over date. If a multiple of expected benefits does not reach at least 10, then the assets should not be deemed sufficient to generate enough investment earnings to finance a substantial portion of expected benefits. I did not just make up the factor of 10. At a factor of 11.2, assets generating a 7% return will be sufficient to pay 80% of the benefits (as mentioned in the context of pension above). So I rounded it to 10. It could be more or less; maybe even 5 (paying 40% of benefits at 7%). But I would be more comfortable with 10. If this approach appeals to the Board, you might consider adding the year in which the factor of 10 is reached or exceed in paragraph 50 of the Employer OPEB ED, as a nudge toward ensuring the multiple is reached before using the long-term expected rate of return.

A more principles-based approach could be crafted. The language below does not feel like it is the best. So I am sure the Board and Staff could tweak this or throw it out and start over – to craft an appropriate principles-based approach to close the loophole. Following is a suggestion for amending paragraph 42(a) in the Employer ED, as follows:
a. The long-term expected rate of return on OPEB plan investments that are expected to be used to finance the payment of benefits, to the extent that (1) the OPEB plan’s fiduciary net position is projected (in conformity with paragraphs 35–37) to accumulate to significant levels to be sufficient to make projected benefit payments (determined in conformity with paragraphs 28–33) and (2) OPEB plan assets are expected to be invested using a strategy to achieve that return, generating investment earnings to finance a significant portion of benefits over time.

There are other similar paragraphs in the Employer and Plan EDs that would be similarly amended.

I am not completely confident that the principles-based amendment above would be sufficient to close the loophole. But the more prescriptive approach (factor of 10) would do it.

With either approach, a paragraph in the Basis of Conclusions would be appropriate to explain this principle.

5. Medicare Payments – Essential nature

The last sentence of paragraph 30 and footnote 10 in the Employer OPEB ED provide insufficient guidance on how to treat the various types of payments from the Federal government. Paragraphs B41 and B42 do not fill the gaps either.

Paragraph B41 refers to “reimbursements” and says, “This Statement includes a requirement to reduce projected OPEB payments by the amount of reimbursements for Medicare benefits provided through the employer’s OPEB plan.” I cannot identify where this Statement expresses that requirement. Maybe I just missed it.

Paragraph B42 refers to subsidies, and says, “The Board concluded that subsidies associated with these benefits should not be considered in the projection of OPEB payments.”

This disparate treatment between reimbursements and subsidies expressed in the Basis for Conclusion is not so apparent in the Statement itself. Neither is the definitional difference between “reimbursements” and “subsidies”. Paragraphs B41 and B42 seem to explain the difference by referring to whether the benefit rights are conferred upon an individual by the Medicare statutes (Medicare benefits) versus by the employer/plan promise (plan benefits). Following is how I read the Standard and the Basis for Conclusions.

If this is not how the GASB intended its wording to be understood, I request that the wording be revised to clarify its intent. Even if it is how the GASB intended its wording to be understood, I request the wording be revised to be clearer.

- Example 1: It feels like the Basis for Conclusion is saying that any payment by the Federal government related to those prescription drug claims or prescription drug premiums which are paid by an OPEB plan or an employer should not reduce the projected benefits under this Standard because the right to prescription drug coverage is not conferred upon a member by statute but by the plan or employer. Prescription drug coverage is not a Medicare benefit. In the language of the Basis for Conclusion, these are “subsidies”. Under current law, these payments include Retiree Drug Subsidies (RDS) and Employer Group Waiver Payments (EGWP).
A point of information might be useful here. Some health plans are managed by the state government and include the state and other local governments as participating entities. The state group insurance department runs the plan and it files with Medicare to obtain RDS or EGWP payments form the Federal government. This arrangement can cause some confusion in discussing these matters. The state may be acting as an agent on behalf the participating entities. Some may refer to “the plan” when they mean the state as agent. On the other hand, the state may be acting as an insurer to the local entities. There may be agency accounting rules at play here that are beyond my expertise. But I raised these issues to give the Board and Staff food for thought as you craft improved versions of this guidance.

- Example 2: In the case of a stand-alone fully insured contract sold by an insurance company to an employer or plan to cover prescriptions drugs, there is no voluntary nonexchange transaction between the Federal government and the employer or plan. The Federal government’s payments made to the insurance company (regardless of how they are calculated) are invisible and not relevant to the employer or plan. The insurance company enters into a transaction with the Federal government for these payments, not the employer or plan. Thus the projected benefits under this Statement are the expected net claims or premiums approximating net claims as charged by the insurance company which are payable by the employer or plan.

- Example 3: The Federal government’s payments made directly to providers which serve to offset an OPEB plan’s benefits under the OPEB plan’s formulas and benefit provisions (e.g., coordination of benefits or other Medicare integration method) should reduce the projected plan benefit under this Statement. The payments by the Federal government are made because they constitute a benefit of the Federal government not a benefit of the employer or plan. Therefore, those payments can and should be part of the calculation of the net plan benefits under the OPEB plan.

- Example 4: The Federal government has risk contracts with employers and plans under which it makes payments to the employer or plan in exchange for the transfer of the Part A and Part B Medicare benefit obligation being assumed by the employer or plan. In this case, the employer or plan actually provides the Medicare-mandated benefits with the funds provided by the Federal government, plus additional benefits. The Federal government initially had the primary responsibility of providing these benefits (Parts A and B) but has transferred the responsibility to the employer or plan under the risk contract. The formula for determining the Federal government is not related to the actual costs, not reimbursements of actual costs, but is a function of the expected costs.

Therefore, B41 reads like it applies to this example. In other words, the payments received from the Federal government should reduce the projected benefits measured under this Statement because they originated with a benefit conferred upon employees by Federal statute, not by the employer or the plan. However, the term “reimbursement” does not exactly describe the nature of the payments. The Federal government is not reimbursing the employer or plan for Part A and B claims.
If this is the how the GASB intends that OPEB benefit projections be made under this Statement, I request that the wording be revised in the Standard itself and in the Basis of Conclusions. Furthermore, I request that the wording be adjusted so as not to simply rely on the difference between “reimbursements” and “subsidies”. That distinction is not helpful.

It seems to me the turning point lies in whether the benefit is conferred upon the member by the Federal statute (Medicare or Tricare) or by the employer or plan.

6. **Attribution Start Date** – OPEB benefits often do not “accrue”

Paragraph 40(c) refers to the “first period in which the employee’s service accrues OPEB under the benefit terms”. This may not be much help. OPEB benefits do not “accrue” in the usual sense in which pension benefits accrue. We think of pension benefits accruing pursuant to a formula that increases the benefits earned for each year of service. Most OPEB benefits do not accrue that way. Even for the ones that grant a stipend or discount per year of service, the implicit subsidy portion of that OPEB does not accrue that way.

I suggest revising paragraph 40(c) and other similar paragraphs as follows:

   c. The beginning of the attribution period should be the first date on which the employee performs service covered by the OPEB plan period in which the employee’s service accrues OPEB under the benefit terms, notwithstanding vesting or other similar terms.

7. **Sensitivity Testing** – Overkill

The calculation of 8 additional scenarios in a full actuarial valuation year and roll-forwards in off-years (for biennial valuations) seems too costly for the benefit derived. Only the two outside extreme cases are essential.

8. **Fully Pooled Multi-employer Health Plans** – Cost-sharing Similarities and Differences

Consider a fully pooled health plan providing health coverage for the active and inactive employees of many different participating entities. We used to call them community-rated plans; but that name was so misunderstood, that we on the committee that recently re-wrote ASOP No. 6 tried to limit the use of that term.

The title of ASOP No. 6 is *Measuring Retiree Group Benefits Obligations and Determining Retiree Group Benefits Program Periodic Costs or Actuarially Determined Contributions*. It is the Actuarial Standard of Practice that provides guidance on how all actuaries are supposed to measure OPEB obligations and how to determine OPEB costs and contributions.

A pooled health plan bases its premiums at least in part on the claims experience of groups other than the reference employer. A fully pooled health plan bases its premium entirely on the experience of all participating groups, which all pay from the same composite rate table without regard to their own age/gender distribution or claims experience.

Fully pooled health plans have one quality similar to cost-sharing pension or OPEB plans; but also have important differences.
The similarity lies in the intent to share or pool the risk, experience and funding among a large (or not so large) number of participating employers. Each participating employer pays the same composite rate without regard to its own members’ make-up, such as age/gender distribution or benefit experience. By participating in a fully insured health plan, an individual employer might be getting a great price because its age/gender distribution is less favorable than the other participating employers and might otherwise have to pay a higher premium because of its age/gender distribution. Also, the employer might have worse claims experience in any one year (or repeatedly) even if the age/gender distribution is not the cause. It could, and does, go the other way as well for other employers. Some do better and some do worse. But all pay the same composite price in a fully pooled health plan.

There is some danger in assessing the appropriateness or inappropriateness of these proposed OPEB standards by placing too much emphasis on this similarity.

Some have noted that the GASB rules call for allocating a cost-sharing pension or OPEB plan’s total collective costs and liabilities among participating entities using proportionate shares based on contributions. They argue for extending that basis to the determination of OPEB costs and liabilities of an individual employer participating in a fully pooled health plan by basing the individual employer’s OPEB costs and liabilities on its contributions (i.e., premiums to the fully pooled plan) instead of the value of benefits promised to its particular members. Remember, in fully pooled health insurance plans, the premiums paid by the employer (and its active and retired employees) do not directly relate to their own particular members’ benefits.

The differences between fully pooled health plans and cost-sharing pension or OPEB plans (as relevant to these OPEB EDs and ASOP No. 6) lie in: what cost is being shared, the employment status is covered, the length of time and the actuarial management.

a. What cost is shared? In a fully pooled health plan, the cost of medical bills for active and inactive members is being shared. But in cost-sharing pension and OPEB plans, the cost of employer-subsidized benefits after retirement is being shared.

In fact, for a cost-sharing OPEB plan, the underlying health insurance plan need not be a fully pooled health plan. Each participating employer in a cost-sharing OPEB plan can have its underlying health insurance plan provided through different policies with different insurance vendors.

b. What employment status? Fully pooled health plans pay the medical bills of both active and inactive employees, while some pay the medical bills only for inactives. However, all cost-sharing pension and OPEB plans provide subsidized benefits only to inactives.

c. What length of time? A fully pooled health plan shares the cost of medical bills expected to be paid only for the next one year, generally speaking; whereas a cost-sharing pension or OPEB plan shares the subsidized benefits expected to be paid to inactives for decades after retirement.

d. Actuarial management. This may be the most important reason the contribution-based proportionate share approach for assigning OPEB costs and liabilities to participating employers in a cost-sharing plan is not portable to a fully pooled health plan.

   • Cost-sharing pension and OPEB plans already engage actuaries at the plan level to calculate the total collective pension or OPEB costs and liabilities for funding and accounting purposes. So it was natural for the GASB to rely on that actuarial
management structure to require the plan actuary to calculate the relevant numbers for plan reporting which would form the basis for employer accounting and reporting.

- Fully pooled health insurance plans do not have that structure in place already. They may employ healthcare actuaries, but not OPEB actuaries to measure the total collective OPEB costs and liabilities – granted, there are some overlapping skill-sets, but it is a very different actuarial engagement. The GASB does not have the same leverage over a fully pooled health plan as it does over a cost-sharing pension or OPEB plan.

Usually, without *fully pooled* health coverage (i.e., when the employer’s health insurance plan premiums are derived in large part from the age/gender distribution and especially the claims of its own members), the cost of benefits for an individual employer bears a reasonable relationship to its cash outflow over time.

I recognize that for fully pooled health plans, however, an individual employer’s cost of benefits to its own members may differ from the cash outflow paid to the fully pooled plan over time – and significantly so, for outlier employer’s whose demographics differ significantly from the pool as a whole. I recognize that there is a disconnect between the accounting liability held and the cash outlay over time, particularly for such outlier employers. I recognize that some employers will be reporting more OPEB benefit liability than is reflected in their respective cash outflow expected over time – assuming the same arrangement remains in place, those employers will never have to pay that liability they have recorded. On the other hand, some other employers will be reporting less OPEB benefit liability than is reflected in their respective cash outflow expected over time (assuming the same arrangement remains). But that is the nature of a pool.

Cross-subsidies occur everywhere in health insurance programs:
- Cross-age subsidies giving rise to the implicit or implied subsidies the GASB dealt with many years ago, cross-tier subsidies (employee rate subsidizing dependent rates),
- Cross-Medicare subsidies (sometimes Medicare-eligible inactives subsidizing non-Medicare eligible inactives),
- Cross-union subsidies (when some unions negotiate a better deal within the same health insurance program), and
- Cross-employer subsidies (occurring mostly due to cross-age subsidies in fully pooled health plans), etc.

These cross-subsidies are simply part of the nature of pooling.

The principle is to measure the benefits promised, not the cash outflows under the current insurance arrangement in place. A current insurance arrangement in place may be replaced by another, or not. This is similar to the principle the GASB applied in pensions (and the OPEB EDs) to measure the benefits ultimately promised to members not the funding requirements. This rejection of a measurement based on funding (whether contributions or premiums) applies regardless of whether the funding is by a cost-sharing plan or by a fully insured health plan.

The obligation we are measuring is not a funding obligation but a benefit obligation.

9. **Additional Note Disclosures** – Unique to OPEB

The Note disclosures required in paragraphs 49-51 of the Employer OPEB ED were taken from the pension standard. Those are still essential disclosures. One new assumption unique to OPEB was added, healthcare cost trend rates. But I suggest the addition of a few more:
• The rate(s) of participation or rate(s) of rates of acceptance and lapse of OPEB coverage
• Any assumption concerning the proportion of total costs covered by Medicare.
• Whether the OPEB benefits are provided through a fully pooled multi-employer health plan and how the initial per capita costs were developed [this one is needed because the costs and liabilities of a small percentage of OPEB plans may have anomalies that need explaining].

The total OPEB liability is particularly sensitive to these assumptions and they should be considered essential to a user’s understanding of the balance sheet liabilities.

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

This request might require a lot of additional work by Staff; but I believe it is essential for the GASB’s mission.

The formatting and organizational structure was way too complex. This was true of Statement No. 67 and 68, and became unbearable in these three EDs. So much so, that you have a serious risk of not communicating your guidance. No, it’s not just a risk; it’s a certainty.

There is a lot of very good work in there. It is just too difficult to follow.

I recognize you have templates or business systems that dictate how you organize your standards. But they need to be re-visited and revised, please.
  • I have seen vertical bars with text in them used effectively to remind the reader where he or she is in the document (it might take a couple such bars on every page).
  • Certainly headers and footers are needed.
  • Also, if you just start the top of each page with: “. . . (Continued)”, it would help.

I suggest using all these, and any other creative ways, to communicate where the reader is in the context of the organizational structure. It might even be necessary to literally change the organizational layout, not just explain better where the reader is at any point in time.

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
September 30, 2013

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Re: Exposure Draft on Measurement of Elements of Financial Statements

Dear Director, Staff and Board Members:

Thank you for the opportunity to share some brief thoughts about the GASB’s Concepts Statement (CS) Exposure Draft (ED) relating to Measurement of Elements of Financial Statements. And thank you for all the hard work you all do for the public.

I am writing about the relationship of this CS ED to GASB Statement No. 68 and the Other Post-Employment Benefits project you are currently deliberating. I am writing primarily to agree and commend the Board on its definition of Settlement Amount, as set forth particularly in paragraph 39(b) of this CS ED.

Background

As this CS project was being deliberated over the past several years, so was the Pension standard (and more recently the OPEB project). They have been running parallel. I was following the pension project (and now OPEB) most closely; but I was also watching this measurement project out of the corners of my eyes. Not being an accountant, I was continually running to stay up with you all.

But I saw the connection. While both projects were being deliberately concurrently, I did not know which one would be completed first. I was pleased with the direction the Board was going with the Pension measurement principles it had tentatively adopted; and pleased, of course, that they found a home in the final version now known as Statement No. 68 (and 67).

I knew the measurement of the Pension liability was going to need to fit nicely into whatever the Board would finalize concerning the CS on measurement. As it became clear that the Pension standard would be adopted before the CS, I was concerned that the final CS might not contain adequate language to capture the measurement principles already adopted in the Pension standard.

My desire for consistency was driven by the notion that if the Pension measurement principles were good enough for the Board to adopt for a Pension standard, at roughly the same time as deliberating a measurement CS, then they were good enough to be captured within the final CS on measurement. I think you did exactly that -- in paragraph 39(b) of this ED.

But this concept is not limited to an application solely to Pensions and OPEBs. It feels like it might authorize a similarly appropriate application to other types of liabilities.
Pension and OPEB Settlement

When discussing the settlement and valuation of Pension and OPEB obligations with my financial economics friends, I have often described Pension and OPEB liabilities as being “settled a little at a time over a long period of time”. That phrase reflects the terms of the arrangement -- the ongoing settlement agreement embodied in the exchange transaction between the employer and employee. Paragraph 39(b) states:

“A settlement amount can be either (a) the amount that the counterparty would accept to settle the liability or would pay to satisfy a receivable at the date of the measurement or (b) the amount that will be realized from an asset or will be needed to liquidate the liability in due course according to the terms of the arrangement between the government and the counterparty.” [My underline emphasis]

This subparagraph authorizes the measurement principles in the Pension standard which capture the current value of the long-term cost to taxpayers and the basis for the cost of services. Without the concept described in paragraph 39(b), the Board might face a challenge in proceeding with the OPEB standard.

For Statements 67 and 68, the Board specifically rejected a market or fair value model, in favor of a model with these qualities:

- **Counterparty.** The Pension standard measures the government’s obligation due to the counterparty. That is very different from the market or fair value model promoted by many who call for an exit price marked-to-model for a transaction with a third party, leaving intact the basic obligation to the counterparty at the same default rating (a poor model for marking a fair value I might add). The Pension standard reflects a settlement with the plan members of its obligation to them. And so should the OPEB standard.

- **In due course according to the terms of the agreement.** The Pension standard measures the obligation embodied in the career-long exchange transaction between the employer and employee. It reflects the amount needed to liquidate the liability in due course according to the terms of the arrangement. If the net pension liability, as measured per the Pension standard, were added to the plan’s fiduciary net position, there would be sufficient assets to liquidate the Pension liability (attributed to date) in due course according to the terms of the arrangement (under the given set of assumptions). And so should the OPEB standard.

Preserving the nature of the obligation’s original terms and conditions in its due course measurement seems an important attribute to capture whenever appropriate. Governmental sector Pension and OPEB liabilities are seldom ever settled in a single sum and seldom ever discharged in a transaction with a third party. They usually have a similar life expectancy as the government itself.

Because the benefit structure is in place, operating perpetually (usually) to compensate a perpetual workforce, the measurement of the attendant obligation feels almost like a “value-in-use”. Paragraph 39(b) authorizes that, the last sentence of paragraph 36 emphasizes that, and the actuarial profession has a long-standing and formalized process for measuring the obligation on that basis.

Without this language in paragraph 39(b), this Board and future Boards would be challenged to justify the Pension measurement it has just recently adopted and similarly challenged to shoe-horn the tentative decisions made in the OPEB project.
• **Remeasurement.** The Pension standard describes a remeasurement of the Pension liability on every measurement date. However, on each new measurement date it is no longer the same liability. That makes the remeasurement of most Pension liabilities very different from the remeasurement of many other liabilities and similar to a few others.

• **Expected cost.** The Pension standard for funded pensions calls for the current value of the long-term “expected” cost to taxpayers, i.e., the amount “expected to be needed” to liquidate the liability (attributed to date) in due course according to the terms of the arrangement. It is a best estimate of the cost to taxpayers. It is not a “fair value” or a “market value” or a “market-consistent” value. Those do not reflect the long-term cost to taxpayers. But an “expected value” does. And so should funded OPEBs.

**Conclusion**

After this lengthy commentary on what you did (although my shortest comment letter ever), I agree and commend the Board for including among the measurement attributes a variation on “settlement amount” as the amount that is “needed to liquidate the liability in due course according to the terms of the arrangement between the government and the counterparty”.

**Suggestion 1**

You might consider additional language concerning choices among various numbers for a given approach/attribute. Values that involve fixed quotes at a point in time (bid/ask) might need some concepts elucidated. Values that are contingent on future factors or variables may have generally reliable probability distributions associated; and language concerning the concepts of how “expected value” versus guaranteed value or ranges such as more-likely-than-not or equally-likely might affect the concept of fair representation could be considered.

It has always seemed to this non-accountant that “expected values” better convey the notion of fair representation and best estimates than do methods that tilt toward conservatism or worse-case-scenarios, or that we should err on the high side for liabilities and the low side for assets. Is this a measurement concept?

**Suggestion 2**

I recognize that, once the measurement CS is adopted, the Board cannot go back and clarify how the Pension standards’ measurement principles were consistent with the newly adopted measurement CS.

However, as a matter for clarity, the Basis of Conclusions for the OPEB standard will likely refer to the Board’s reliance on the Pension standards. To take that a step further, the OPEB ED and Standard’s Basis for Conclusion would be the perfect place for an explanation of how its measurement attributes fit into the concepts set forth in paragraph 39(b) of this CS.

Again, thank you for this opportunity and for all your hard work.

Sincerely,

James J. Rizzo, ASA, MAAA