August 29, 2014

Director of Research and Technical Activities
Project No. 34-1E
Governmental Accounting Standards Board
PO Box 5116
Norwalk, CT 06856-5116

Re: Actuarial Cost Method for Postemployment Benefits other than Pensions

I urge the Board to allow the use of the Projected Unit Credit (PUC) method instead of the Entry Age Normal (EAN) method for OPEBs. While EANC is the best method for pensions, it is not for these benefits. The main reasons are below.

1) Communication with Boards. It is extremely hard to explain the EAN method; some actuaries explain it the same as PUC. Some employers who have used other allowable methods previously will want the methods discussed. Both methods give the same present value and that is what is most important.

2) Benefits are not based on pay. Allocation of present value to time periods by service is most sensible since benefits are typically based partly on service and not on wages. Cost allocation to employees of same age and service should be independent of wages. It makes total sense that if one retires with 25 years of service, the benefit should allocated 1/25 to each year. We cannot explain what EAN does.

3) To allocate the present value between past and future, the EAN method needs premiums/claims back to earliest hire date. If select and ultimate trend was used, there can be gain or loss even if assumptions were met based on how past costs are determined. The assumptions about past premium increases are not shown in actuarial reports so it is hard to match results or comment on the work of other actuaries.

4) Nothing we can do will result in stable costs in relation to payroll. If the pay for an entry-level job rises 3% when claim costs/premiums increase faster, the next year’s new employees cost more in relation to wages than last year’s did. Entry-age normal can produce stable costs for pay-related pension plans, but with the assumptions almost every actuary uses, it will not happen for OPEBs. Since the main advantage of EAN does not apply for OPEBs, we should not use such a complex method.

5) Assumptions are much more important than method selection for retiree medical valuations. We can use an ultimate trend of below 4% to above 6% and a range
of discount rates; this produces more range in results than changing cost methods. We can use many select years of premium increases assumed - or as few as none. Since GASB is so flexible on assumptions, you should allow actuaries to choose the PUC method for retiree medical.

I would like to discuss this in person with the Board at the public hearing in San Francisco on September 12, 2014.

Sincerely,

Steven T. Itelson
Fellow, Society of Actuaries
Member, American Academy of Actuaries