August 29, 2014

Director of Research and Technical Activities
Governmental Accounting Standards Board
401 Merritt 7, PO Box 5116
Norwalk, CT 06856-5116

Re: Project No. 34-1E Exposure Draft on Accounting and Financial Reporting for Postemployment Benefits Other than Pensions

Dear Director:

On behalf of the Segal Company, we are writing in response to the GASB’s request for comments on the Exposure Draft Accounting and Financial Reporting for Postemployment Benefits Other than Pensions. We also take this opportunity to express an interest in attending the public hearings held in New York, on September 10, 2014.

Founded in 1939, the Segal Company has extensive experience in providing independent, results-driven actuarial and consulting services to state and local governments. For 75 years, we have developed innovative total reward approaches that provide quality health care, secure retirement, and competitive compensation programs for public employees.

We thank you for the opportunity to comment on the Exposure Draft. We commend the GASB and project staff for their efforts in striving to understand the complicated and interconnected issues around accounting for postemployment benefits other than pensions (OPEB). We have organized our comments based on topic, as follows:

- Pensions vs. OPEB benefits
- Calculation of net OPEB liability
- Calculation of OPEB expense
- Reporting
Pensions vs. OPEB Benefits

We agree that increased transparency and consistency are important for comparison among public employers. We also note that many of the requirements in this Exposure Draft have carried over from the pension standard and we agree with some of the carryover. However, OPEB benefits are different in many ways from pension benefits. The Board took the view that OPEB benefits are a career long promise to its employees. We disagree with this view. Unlike pensions, which generally have strict requirements for vesting and funding, OPEB benefits are generally an implied promise that can be changed (or eliminated) at any time. In addition, many plans and employers fund OPEB benefits using a pay as you go funding policy, which is not considered in the Exposure Draft (if there are assets, they would never run out in a pay as you go funding policy). In addition, because the actuarially calculated unfunded liabilities associated with OPEB are generally as large as or larger than the unfunded liabilities for pension benefits, and generally are not funded, an unintended consequence of this Exposure Draft could be a plan sponsor decision to eliminate or drastically cut these benefits. Given the less-certain nature of OPEB liabilities compared to pension liabilities, such decisions may not be appropriate. This possibility brings into question the decision-usefulness of the reported liabilities. We think the requirements of this Exposure Draft should take these facts into account.

Many OPEB plans are not funded, or have very little assets in place to pay for benefits. GASB chose not to describe any requirements in regard to funding. Similar to the pension statements, the Board has separated OPEB funding (which is not required) and OPEB accounting. Under GASB 43 and 45, the current standards for accounting and reporting, the annual OPEB cost (AOC) is the measure of OPEB expense. The AOC is based on the annual required contribution (ARC) which is a measure of the actuarially determined contribution necessary to fund the benefits, assuming that an employer or plan is determined to fund the liability. The users of these financial statements will need to understand the difference between two cost numbers—the new GASB expense and the actuarially determined funding requirement (if calculated). Which one would be considered the “real cost” by people reviewing these numbers?

Lastly, whereas the value of pension benefits are based on benefits that can be calculated and are known to be paid out over time, the value of OPEB benefits are based on benefits that are volatile from year to year and include many assumptions concerning retiree behavior. For this reason, treating OPEB benefits the same as pension benefits for accounting and reporting does not seem appropriate.

Calculation of Net OPEB Liability

The Exposure draft defines the net OPEB liability as the OPEB liability offset by the OPEB plan’s fiduciary net position. A plan’s fiduciary net position, namely the fair value of assets, can have significant fluctuations. In addition, OPEB expenses can also be very volatile by their nature. Using the fair value of assets will cause even greater volatility, and does not reflect the true nature of the benefits and their value. The calculation of OPEB expense allows for smoothing of the change in asset value over 5 years. We think that there should be a consistency between the net OPEB liability and the OPEB expense.
GASB Statements No. 43 and 45 created a process where the net OPEB liability is gradually introduced onto the balance sheet. This recognized that, since OPEB benefits are so volatile, a gradual introduction of the net OPEB liability over a number of years is more desirable.

We understand the Board’s desire to use a single actuarial cost method for the purposes of disclosure so that plans can be compared. However, there are many instances where the Entry Age actuarial cost method may not be the appropriate cost method. Projected Unit Credit, in many cases is more appropriate. We recommend allowing the actuary to use either Projected Unit Credit or Entry Age as the actuarial cost method and require the disclosure to contain the rationale for using such method. If having the choice of two cost methods not a consideration, we would then recommend Projected Unit Credit as the required method. If the Entry Age actuarial cost method is the required basis, then at a minimum, due to the fact that most OPEB benefits are non-salary based, the actuary should be given the flexibility between a level dollar or level percentage-of-pay basis.

In calculating the blended discount rate, the Exposure Draft requires there to be a projection of the benefits and a projection of the contributions for current actives and retirees. As stated earlier, many OPEB plans have a funding policy of contributing the pay-as-you-go amount to their plan (that is, paying benefits as they come due). Please clarify how one would calculate the discount rate in the following scenarios:

- The funding policy is pay-as-you-go (benefits are paid as they come due), but the plan has some level of assets, possibly de minimis. The plan assets, therefore, are never zero. Does this mean that the long-term rate of return can be used in all years?

- A plan is projected to have zero assets at some point in time, but eventually will begin to accumulate assets at a later point. (An example of this would be a plan change that significantly reduces benefits for future retirees, and the plan reduces its current contribution level accordingly.) Does this mean that the blended rate will be based on the long-term rate of return for those years that assets cover benefits and the municipal bond rate for those years that they do not?

The Exposure Draft requires that the actuary’s calculations be based on the substantive plan as it exists on the Measurement Date. Under the current standards, actuaries are able to recognize changes that are known in the future, even if they have not taken effect on the measurement date. One example of this would be plan changes that are to take effect to avoid the Excise Tax on High Cost Health plans as required by the Affordable Care Act. We recommend that any plan changes or policies that are known or formally adopted by the financial statement date be recognized at the time of measurement.

**Calculation of OPEB Expense**

The Exposure Draft requires immediate recognition of plan changes and deferred recognition of changes in assumptions or gains/losses due to differences between actual and expected experience. For many OPEB benefits, particularly insured medical benefit plans, calculating the amount due to plan changes and the amount due to assumptions is not always known as
insurance companies provide one rate. Allocating the changes between assumptions and plan changes will require professional judgment as in most cases the information will not be made available to the actuary. In addition, changes in assumptions or gains/losses due to experience are to be recognized over a closed period equal to the average remaining working lifetime of active and inactive employees. A concern is that some assumptions may only apply to active employees and recognizing them over the remaining working lifetime of an inactive employee (0 years) seems inappropriate.

Recognizing plan changes immediately in expense introduces expense volatility that is not necessary, given the long term nature of OPEB obligations. This approach will create a one year additional expense that will be assigned to taxpayers in a single year, which results in inter-period inequity. This approach also makes it more difficult to compare plans and employers as different entities will update their plans at different points in time. We think that plan changes should be amortized over the remaining working lifetime for actives or, in the case of retirees, remaining future lifetime. We suggest that amortization be based on the participants affected by the plan change.

Lastly, for those plans that have accumulated OPEB assets, the draft allows for spreading deviations from expected earnings on investments over a five-year period. This is inconsistent with the calculation of the net OPEB liability, which does not allow for any asset smoothing. We agree with allowing deviation smoothing over a five-year period and think that the assets should also be smoothed in the net OPEB liability.

**Reporting**

The Exposure Draft requires biennial valuations. This can be cost prohibitive for very small plans. The alternative measurement is available to plans/employers with less than 100 participants, but we recommend that the threshold number should be higher as it will give more flexibility to small employers/plans that lack the financial ability to hire an actuary to perform these calculations.

We agree that the sensitivity of the calculations should be disclosed to the users of these calculations. However, we believe the nine calculations required by the exposure drafts create a few issues. First, too many numbers can be confusing to the reader and could actually diminish the value and credibility of the actual calculation. In addition, the cost of nine calculations will be prohibitive for a number of small public employers/plans. We suggest presenting two additional scenarios that will show the sensitivity of the discount rate and trend rate on the calculation. We recommend a calculation using discount rate plus one percent and a calculation reflecting trend minus one percent. In this respect, the reader will be able to identify how a change in trend and/or discount rate will affect the calculation without having to look at nine calculations and try to determine how much of the difference is due to discount rate versus trend. This will achieve the goal of reflecting the sensitivity and volatility of the calculation and not create a financial burden on the employer or plan.

Understanding how the numbers have changed over the years is a very important information for persons viewing these numbers. As such, the Exposure Draft requires an exhibit reflecting the
net OPEB liability and expense over the prior 10 years if feasible. However, this likely will not be feasible in most cases unless the employer has used the Entry Age actuarial cost method in its prior calculations. It would also be cost prohibitive for smaller employers. If an employer has used the Entry Age actuarial cost method in its prior calculations, please clarify whether they should create the historical exhibit using the numbers that are available, even if it is incomplete. In addition, it is highly unlikely that the discount rate used in any previous period calculations would be consistent with the requirements of the Exposure Draft. If the historical information cannot be adjusted to conform to the Exposure Draft requirements, is it preferable to not report it, or to report it with an explanation of how it does not quite comply with the Exposure Draft requirements?

We thank the Board for the opportunity to comment on the Exposure Draft and thank you for your consideration.

Sincerely yours,

Cathie Eitelberg
National Director, Public Sector Market
Senior Vice President

Mary Kirby, FSA, FCA, MAAA
National Retiree Health Practice Leader
Senior Vice President & Consulting Actuary

8055271V1/96011.001