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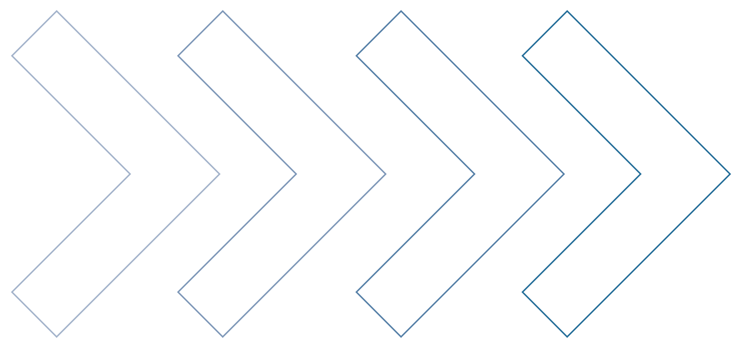

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Letter from the Editor

By Jeffery M. Rykhus

Welcome to a new year and a time of potentially significant change, at least for our U.S. members. The new presidential administration promises change on many fronts that, depending on your point of view, may be positive or negative. In particular, they have promised change, especially in health care reform under the Affordable Care Act (ACA).

On one hand, the stage is set for participants in the individual market to potentially lose their health care coverage or be required to pay more for it. There could also be more limited options available in many counties, if repeal of the ACA or other changes spook insurers. On the other hand, insurers, providers, actuaries, consumers and others all have an opportunity to influence the direction that health care reform will take, and it's possible that this administration will listen closely to those individuals and organizations that seek to opine on the subject. Personally, I'm excited to see the results of the Robert Wood Johnson Foundation and Milliman Actuarial Challenge currently underway "to increase the stability of the health insurance market."

I think this year can be a tremendous opportunity for individual health care actuaries, as the health care landscape changes and takes a new shape. There will be much more to learn and new things to put into your actuarial toolkit. We are potentially at a major turning point, perhaps lasting decades, not only in health care, but also in all other aspects of social insurance.

At the time this publication is going to press, Medicare, Medicaid, Social Security and the ACA are all potential candidates for change within this administration. Although some might be alarmed at what they see as the perfect storm of political forces aligning to reduce social insurance programs, I think that these changes will be less drastic than some fear, primarily because no political party wants to eliminate so much that they are voted out of office. As I write this, members of congress considering changes to the ACA are far from reaching any consensus, and who knows when a replacement law will be considered.

The Social Insurance and Public Finance Section (SI&PF) will be closely following upcoming legislation and the administration's new policies. Stay tuned. In this time of anticipated change, the SI&PF council welcomes articles that examine the actuarial issues around social insurance and public finance. Contact me or anyone on the SI&PF council if you'd like to contribute an article. ■

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Chairperson's Corner

By Steve Bryson

"In the Public Interest." The first words you read when picking up our section newsletter. I've been thinking about that message lately. What does it mean, and what does it say about our section and about us as section members?

An acquaintance recently told me that it's arrogant to pretend to act in the public interest. Is that what we're doing? Pretending? I don't think so.

I joined this section because I saw an opportunity to join with like-minded actuaries who wanted to unselfishly give back to the profession and, at the same time, work for the public good. I had the same motivation when I decided to run for council. During the last two years, I've had the pleasure of working with my fellow council members and the SOA support staff to advance our mission of research, education and outreach about publicly funded financial security programs. We've promoted research about the funding of public pensions and retiree health programs (the latter is just now getting started), sponsored education about the U.S. Social Security and Medicare programs, established forums for collegial debate about public pension funding methods and assumptions, and so on. You get the idea.

The Social Insurance and Public Finance Section is fairly unique in the universe of SOA sections. Unlike many other sections, our primary focus is not on supporting our members' practices. There's nothing wrong with that, of course, and I certainly don't mean to imply that we are in any respect superior or more important than other SOA sections. But I do appreciate that our *raison d'etre* is to do what we can as actuaries to improve the financial health of our public security systems, and, in the pursuit of that goal, somehow make this planet a better place in which to live.

So, where do we go from here? Onward and upward, I hope. I invite you to join us and lend your voice and leadership to our mission. Become a Friend of the Council. Submit an article for our newsletter. Volunteer to speak at one of our meeting sessions or webcasts. Or consider running for council next summer. There's plenty to do. Please contact me or a member of the SOA section staff for more information.

Thanks for the soapbox. ■

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Accounting for Liabilities of Social Security Systems

By Robert L. Brown

This paper reviews proposals from the International Public Sector Accounting Standards Board (IPSAS-B), the International Monetary Fund (IMF) and Eurostat in relation to the reporting of pension liabilities in national accounts. This is sometimes referred as the implicit pension debt. A discussion took place at the Annual Geneva Forum of the International Actuarial Association (IAA), the International Labor Organization (ILO) and the International Social Security Association (ISSA) in Budapest on Sept. 14, 2015. This article summarizes these discussions in relation to public pension funding strategies other than full-funding approaches (e.g., defined contribution plans).

The expectation is that the new valuation methods proposed will exclude directly government-financed national health services, plus long-term care, and workers' compensation, but this is not perfectly clear at this time.

The IAA would prefer to see a clear distinction made between social security on the one hand and "employer-sponsored benefits" on the other, the latter referring to benefit programs where the government is acting as employer for public-sector workers. Provision of pension and other benefits where a government is acting as the employer and providing benefit programs solely for government employees similar to those provided by private-sector employers for their employees should **not** be included under this social benefit standard.

The term "social security" would then be confined to public benefit systems that apply to the whole population or significant subsections of the population.

Implicit debt is the result of a summation of expected future deficits in the system. Implicit social security pension debt would, under the proposals, equal the present value of all future benefits to present pensioners and all accrued rights of current contributors/taxpayers, minus the amount of the initial reserve of the pension system. This definition follows a strict private insurance concept and may, therefore, be inappropriate.

This amount thus also equals the resources that would be required to close down a social security system (in order to start a new one) while honoring all past commitments. No major social security system around the world has a termination level of reserves. For social security systems, which are not secured by amounts of invested financial resources, but, rather, by societal commitments and contracts between generations, this level of funding is unnecessary. This notion of debt has little relevance as an indicator for the overall financial status of a social security pension system or its sustainability.

The application of the guidelines is likely to affect the value of national debt figures and increase the focus on social security systems. It is, therefore, important that any indicator of pension liabilities produced is presented in such a way as to minimize the risk of misinterpretation by the media and other users, and to avoid being incorrectly used as an indicator of financial non-sustainability of the pension system.

The methodologies should enable accurately assessing the long-term financial sustainability of social security systems without a bias for or against a particular funding approach.

There are two approaches that are currently being discussed:

(i) "**The Obligating Event Approach**"; and
(ii) "**The Insurance Approach.**"

(i) "**The Obligating Event Approach.**" This approach would be most appropriate for non-contributory social security programs, including means-tested and citizenship-based basic pensions, but also flat-rate pension programs such as Old Age Security (OAS) and the Guaranteed Income Supplement (GIS) in Canada and Supplementary Security Income (SSI) in the U.S., where there are no specific social security contributions and financing is through general revenues.

The IAA hopes that this would include a requirement that disclosures based on the "obligating event approach" be accompanied by a discussion of the program's long-term sustainability.

(ii) **"The Insurance Approach."** This approach is relevant for social insurance systems financed by designated contributions, including situations where contributions are made by employers and employees. These systems are akin to private insurance in that benefits are paid for by contributions over a period. However, there is likely to be intergenerational and intragenerational solidarity and financing will usually be on an open-group basis, taking into account contributions and benefits for many generations.

Therefore, full sustainability information should include the expected benefit payments and also contribution income in respect of future participants (i.e., an open group).

It would be more informative for decision-makers if the accounting treatment were aligned with the funding methodology, especially when programs are financed using pay-as-you-go or partial funding. For many contributory programs this would involve presenting financial information on an open-group basis. To ignore this will lead to information that is unhelpful and, quite possibly, misleading for decision-making. An open-group approach to financing requires contributions of both existing and future contributors to be considered as assets, with liabilities recognizing future benefits in respect of current pensioners, existing contributors and future contributors.

Treating future benefit payments as liabilities without taking into account future contributions as assets would be particularly erroneous. Even to take into account only certain generations of contributors could be quite misleading. Such approaches fail to recognize the fact that under pay-as-you-go and partially funded systems, in any given year current contributors allow the use of their contributions to pay current beneficiaries' benefits. Thus, there is a claim for current and past contributors to contributions of future contributors. It should be noted that for stand-alone programs financed solely by contributions (without any government subsidy) these claims are not a government debt.

Unlike employer-sponsored plans, accrual of benefits is not always very closely linked to payment of contributions, since not all years necessarily count for additional accrual and some accrual may be deemed rather than actual, in order to allow for periods of sickness, maternity or care-giving. Therefore, the link between benefits and contributions is not considered sufficiently strong to give rise to a financial claim on the part of contributors. Also, because social security benefits can be changed at will by the government as part of its overall economic policy, there is uncertainty about the eventual payment or level of payment of these social benefits.

It is unrealistic to assume that a national pension system could suddenly cease, resulting in a cessation of contributions, as is assumed for occupational private pension plans. Implicit pension debt calculated on a closed group basis may be useful for occupational private plans since companies can go bankrupt at any moment, but it has little relevance as an indicator of the national debt of a jurisdiction. Social security financing is adequate if projections indicate that in each period revenue plus reserves are sufficient to meet benefit payments.

In general, the size of a closed-group implicit pension debt is very large, especially in the Euro area, as suggested by a recent study undertaken by the European Commission (Eurostat)/ECB Task Force on Pensions. According to the results of that study, it is estimated that the closed-group implicit pension debt of social security in the Euro area is 278 percent of GDP, which is approximately four times higher than the government debt. In particular, the social security pension debt for Germany is estimated at the level of 275 percent of GDP, while for France and Italy it is 292 and 322 percent of GDP, respectively. The extremely large magnitude of this theoretical liability raises concerns about the interpretation that the media might make and where this might lead the course of public opinion.

The proposed methodology, which is based on a closed-group accrued approach, is inadequate to fully assess the financial impact of social insurance pension reforms. Any change in the value of the accrued-to-date pension liabilities resulting from a pension reform would only incorporate the impact on current pensions in payment and future pension payments which correspond to the accrued-to-date benefit entitlements of existing, active contributors. However, typically, the largest financial impact of pension reforms is with respect to future pension payments that correspond to the future-service benefit entitlements of existing active contributors and the pension benefits of new workers. This means that under the proposed methodology, the financial impact of pension reforms could potentially be underestimated.

It is unrealistic to assume that a national pension system could suddenly cease, resulting in a cessation of contributions, as is assumed for occupational private pension plans.

We want to show that benefit costs and administrative expenditures are met in full by contributions of employers and

employees, together with investment income. If they are fulfilling this requirement, it would be strange to force them to present financial statements which appear to show something different.

Also, no debt should arise for programs that possess so-called self-adjustment mechanisms.

REMAINING ISSUES

Discount Rate

The IPSAS proposal points towards use of government bond yields for discounting the benefit payments and future contributions, since this would be consistent with what is done for employee benefits. The IAA considers that market-based spot bond yields are not appropriate for unfunded social security liabilities which are to be financed out of future contributions and tax revenues. Moreover, there is an inverse relationship between the yield on government bonds and credit rating of sovereign debt. For countries in a precarious economic position, the cost of borrowing by the government will be high, resulting in smaller social security liabilities. On the other hand, countries with good economic prospects may end up showing larger future liabilities.

The economic basis for discounting would point to using the real growth of GDP or the real growth of the wage mass (or the contributions base for a contributory system) or growth in the real tax base.

For programs that are financed in part by investment income, the discount rate might be based on the future expected real return on the assets, adjusted for risk.

Length of the Projection Period

In the last year of the projection period, the latest cohorts of participants included in the projection will have paid contributions for some time but the benefits to which they will eventually be entitled are not yet paid. Hence, if the projection period is too short, part of the scheme's expenditures for cohorts that will enter the labor force during the projection period are excluded from the liabilities. On the other hand, after a certain number of years, the effect of adding additional projection years has a negligible effect because of the discounting effect. The Office of the Chief Actuary of Canada uses a projection period of 150 years. They have shown that adding more years to the projection has only a marginal impact. It should be noted that, although increasing the length of the projection period enhances the results, it also increases the uncertainty of these results.

CONCLUSION

To conclude, social security systems are secured by intergenerational societal commitments, and they should not be considered as large private occupational pension plans for reporting their assets and liabilities in national accounts. It is suggested to use the open group basis (taking into account future new entrants to the system).

The IAA has replied to the IPSAS-B proposal. This article borrows heavily from that response paper. ■

Robert L. Brown, FSA, FCIA, ACAS, FIA (Hon) retired from the University of Waterloo program in Actuarial Science in 2010 after 39 years of teaching and research. He can be contacted at *rlbrown1949@gmail.com*.

Profiles of Partner Organizations: National Academy of Social Insurance

By Rebecca Owen

This article begins a series of profiles of organizations that are not actuarial organizations but which, nonetheless, have significant impact on actuarial work. The intent of the series is to introduce actuaries to organizational partners for potential joint efforts in actuarial modeling, research and practice.

The National Academy of Social Insurance (NASI) is a non-profit, non-partisan organization based in Washington, D.C. Their mission statement is "to advance solutions to challenges facing the nation by increasing public understanding of how social insurance contributes to economic security." NASI's membership is broad-based, bringing together considerable expertise from many different disciplines. The organization sponsors research on topics that are currently influencing social insurance, as well as addressing how social insurance might best adapt to future challenges.

NASI's primary focal points include Social Security, Medicare & Health Policy, Long-Term Care, Workers' Compensation, Disability, Unemployment Insurance, Workforce Issues & Employee Benefits, International Activities, and Poverty & Income Assistance. NASI publishes reports regularly and many of these are available free of charge on their website *www.nasi.org*, although hard copies must be purchased.

The organization has staff members who specialize in topics such as health (Alexandra Bradley, who helped with this article) or income security. The staff members are a great resource for information about programs and articles on topics relevant to social insurance.

Actuaries may be able to find experts and data through NASI that would be dispersed on *www.nasi.org* or throughout many constituent sites. The staff is very helpful about connecting callers to people who can answer their questions, whether those questions are about personal or social concerns, about access to social insurance, about policy issues at many levels, or about research and data resources.

Every year NASI hosts an annual conference in January which focuses on a particular sphere of social insurance, but always features big, tough issues. Social Security, Retirement Financial Security, Medicare, Medicaid, Worker's Compensation, Unemployment Insurance, Long-Term Care, Challenges of Aging in the Workforce, Health Reform, all vast topics, have been given thorough scrutiny in various years of this conference. The speakers, usually nationally known and widely published professionals, are carefully selected to represent varied opinions and constituencies; the audience is knowledgeable and outspoken. This year the topic is Social Insurance: Opportunities and Challenges Facing the New Administration.

NASI also hosts web events and seminars. The two most recent will show how varied and interesting this content can be.

In October 2016 the organization co-sponsored a webinar on the Affordable Care Act (ACA) with the Solomon Center for Health Law and Policy at the Yale Law School—*Shoring Up the Exchanges: Insurer Withdrawals, the Public Option and the Path Forward*. The speakers were Jacob Hacker, Timothy Jost, Len Nichols and Judith Solomon, and they did a great job of summarizing the policy questions in a way that was both substantive and accessible. The speakers are highly regarded in policy circles; actuaries who wish to examine potential policy changes to the ACA, but want a neutral source may find these briefings useful. (*https://yalelaw.hosted.panopto.com/Panopto/Pages/Viewer.aspx?id=49f295fd-46ed-40d9-a1a4-c9c92f1e38f5*)

NASI also cosponsored a state worker's compensation forum in October and published a report, "Workers' Compensation: Benefits, Coverage and Costs," describing the estimates of cash and medical payments for all of the states, D.C. and federal workers' compensation programs. (*https://www.nasi.org/research/2016/workers-compensation-benefits-coverage-costs*). The report notes that Workers' Compensation Programs have made changes in an effort to manage costs, half of which are for medical care. For health actuaries, this poses an interesting question. Where are the health costs being absorbed when Workers' Compensation programs are cut?

NASI does have more than 30 actuarial members, including Cori Ucello at the American Academy of Actuaries and several staff actuaries at the SOA, but not as many as the subject matter warrants. Including more of the actuarial perspective in some of the discussions would be valuable—this is an organization actuaries want to follow and partner with.

Rebecca Owen, FSA, MAAA, is a health research actuary for the Society of Actuaries. She can be contacted at *rowen@soa.org*.

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Social Security Changes for 2017

By Bruce D. Schobel

Every October, the U.S. Social Security Administration announces certain changes in program amounts that occur automatically—i.e., without any new legislation being necessary. The most widely publicized of these changes is the annual cost-of-living adjustment (COLA) affecting monthly Social Security benefits. Other automatic changes are important to people of working age as well as to beneficiaries. On Oct. 18, 2016, the government announced the Social Security COLA effective for December and the other increases effective for 2017.

BENEFIT INCREASE

Since 1984, Social Security's COLAs have been based on the 3rd-quarter-to-3rd-quarter increase, if any, in the average Consumer Price Index for Urban Wage Earners and Clerical Workers (CPI-W). The CPI-W, which is computed by the U.S. Labor Department's Bureau of Labor Statistics, rose year-to-year from the 3rd quarter of 2013 through the 3rd quarter of 2014; accordingly, all monthly Social Security benefits rose effective December 2014 by 1.7 percent. But the average CPI-W for the 3rd quarter of 2015 was **lower** than the corresponding value for the previous year. Thus, because the average CPI-W did not rise over the applicable measuring period, no benefit increase was effective for December 2015, and the "base quarter" for COLA purposes was not reset. The average CPI-W for the 3rd quarter of 2016 did rise relative to the base quarter, in 2014, by 0.3 percent. Accordingly, all Social Security benefits, in current-payment status or not, rose by the same percentage, effective December 2016. (Note that, as usual, December benefits were actually paid in January; all Social Security benefits are paid one month in arrears.)

MAXIMUM TAXABLE AMOUNT AND TAX RATES

Other automatic Social Security changes are ordinarily announced simultaneously with the COLA but are based on changes in the national average wage, which the Social Security Administration computes from W-2 data. One very important change that affects workers (employees and the self-employed) is the increase in the maximum amount of earnings subject to the Social Security payroll tax each year. The maximum taxable amount increased from $117,000 for 2014 to $118,500 for 2015. But in the absence of a COLA, the maximum taxable amount did not rise for 2016. Because there was a COLA effective in December 2016, the maximum taxable amount rose to $127,200 for 2017, based on the increase in the national average wage to $48,098.63 for 2015. (Note that the 2015 value is the most recent national average wage figure available; at the time of the

announcement, 2016 wasn't even over yet). The Social Security tax rate is not automatically adjusted and has been set by law at 6.2 percent, payable by employees and employers each, since 1990. The self-employed pay both halves of this tax.

RETIREMENT EARNINGS TEST

Another wage-indexed Social Security program parameter is the exempt amount under the retirement earnings test for beneficiaries who have not yet reached their normal retirement age, or NRA. (Social Security's NRA was 65 for workers born before 1938 and is rising gradually under present law to 67 for workers born after 1959.) The annual exempt amount for beneficiaries who will not reach their NRA during the current calendar year rose from $15,480 for 2014 to $15,720 for 2015, and there it remained in 2016, due to the absence of a COLA. This amount rose in 2017 to $16,920. For beneficiaries who reached their NRA in 2016, the exempt amount remained at the 2015 level of $41,880 for earnings in the months before reaching NRA. For 2017, this amount is $44,880. Since January 2000, workers who have reached their NRA under Social Security can earn unlimited amounts without causing any reduction in their Social Security benefits. (In fact, the additional earnings can cause monthly benefits to rise.)

COVERAGE CREDITS

Interestingly, certain wage-indexed program amounts are permitted by law to increase (or even decrease) with or without a COLA occurring. For example, the amount of earnings needed to receive one coverage credit was $1,220 in 2015 and rose to $1,260 in 2016, despite the absence of a COLA that year. The corresponding amount for 2017 is $1,300. Workers who earn at least $5,200 in Social Security-covered employment (or self-employment) during 2017 will receive the maximum four coverage credits for the year. (These coverage credits used to be known as "quarters of coverage"; since 1978, they have been granted on the basis of **annual** earnings, making the old name inappropriate.)

BENEFIT FORMULAS

The so-called "bend-points" of the formulas used to compute primary insurance amounts (PIAs) and maximum family benefits (MFBs) are also wage-indexed and can move up or down with or without a COLA occurring. The two PIA bend-points for workers first becoming eligible for benefits in 2017 (i.e., born in 1955 in the case of retired-worker benefits) are $885 and $5,336. The three MFB bend-points for 2017 eligibilities are $1,131, $1,633 and $2,130. Corresponding amounts for earlier years of eligibility are available at *www.ssa.gov/oact*.

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Funding Public Pension Plans— Show me the money!

By Lance Weiss

The views expressed in this article are solely those of the author, and not necessarily those of his employer. The Society of Actuaries takes no position on the views of the author.

The controversy over the question of what is the "right" measure of pension liabilities continues to gain momentum in the press. In fact, it seems like everyone has an opinion on the issue today, including economists, finance professionals, the press and actuaries. I have a different view of the subject—I believe that all of the rhetoric, debate and even angst over this issue is misguided and actually distracts everyone from addressing the real critical issue facing public pension plans today—**the need for improved public pension plan funding**. I firmly believe the public would receive more value if, instead of just focusing on the very narrow issue of what is the "right" measure of pension liabilities, we all, instead, focus on actions that should be taken to encourage actuarially-based funding of public pension plans. This is the issue on which we all should be spending our time and knowledge—in order to provide our hard working public employees with a sound and secure retirement benefit.

By way of background, in the January 2016 issue of *In the Public Interest*, Paul Angelo discussed the current controversy around the measurement of the liabilities of public pension plans. In this article Angelo did an excellent job of comparing and contrasting the two competing measures of liabilities: current practice using long-term assumptions and methods, including an expected rate of return on plan assets, and an alternative market-based measure using current market rates of interest on relatively secure fixed-income instruments (for example, U.S. Department of the Treasury rates or high-grade corporate bond rates).

The Wall Street Journal, in its Aug. 26, 2016, issue, published an opinion piece on this topic written by Steven Malanga, a Manhattan Institute senior fellow, titled, "Covering up the Pension Crisis." In this opinion piece Malanga presents a number of arguments supporting the use of a market-based measure of pension liabilities. Malanga says, "States and actuaries are trying to stifle debate about the growing shortfall in fund assets."

Malanga, in his opinion, also states, "On Aug. 1, the American Academy of Actuaries and the Society of Actuaries shut down a 14-year-old task force on pension financing when several members were about to publish a paper that found many state and local retirement systems calculate their obligations using overly optimistic future rates of return. The authors want the states and municipalities to adopt new valuation standards that would make projecting the cost of future benefits more predictable. The problem is that this change would also make many public pension funds seem far more indebted than they are under current standards. Such a change would produce more pressure on politicians to boost funding and cut benefits." In fact, the referenced paper was made available online in September 2016 in several places after the publication of Malanga's piece.

With regard to Malanga's insinuation that adopting a market-based measure of pension liabilities will produce more pressure on politicians to boost funding and cut benefits, Malanga failed to recognize that this has already occurred. According to Keith Brainard, Georgetown, Texas-based research director of the National Association of State Retirement Administrators, every state except Idaho has already implemented some kind of pension reform. Further, in a study of 32 plans in 15 states representing 65 percent of participants in its public plans database, the Center for Retirement Research at Boston College found most have already taken steps to reduce future pension costs by some combination of increasing employee contributions, raising age and service requirements for retirement eligibility, trimming salary calculation formulas used to calculate pension benefits and reducing cost-of-living increases.

With regard to his statement that, "Some actuaries say they've been reluctant to speak up about optimistic valuations because they could lose their jobs," Malanga may not have known or considered that actuaries practicing in the United States are bound to follow the Actuarial Standards of Practice and the Code of Professional Conduct.

The Code of Professional Conduct, for example, requires that:

- "An Actuary shall act honestly, with integrity and competence, and in a manner to fulfill the profession's responsibility to the public and to uphold the reputation of the actuarial profession.
- "An Actuary shall ensure that Actuarial Services performed by or under the direction of the Actuary satisfy applicable standards of practice.
- "An Actuary who issues an Actuarial Communication shall take appropriate steps to ensure that the Actuarial Communication is clear and appropriate to the circumstances and its intended audience, and satisfies applicable standards of practice."

With regard to the Actuarial Standards of Practice, there are multiple standards that are applicable to pension plan funding and actuarial assumptions, including the following:

- ASOP No. 4, Measuring Pension Obligations and Determining Pension Plan Costs or Contributions
- ASOP No. 27, Selection of Economic Assumptions for Measuring Pension Obligations
- ASOP No. 35, Selection of Demographic and Other Noneconomic Assumptions for Measuring Pension Obligations
- ASOP No. 44, Selection and Use of Asset Valuation Methods for Pension Valuations

Accordingly, actuaries must provide advice that is accurate, meets the actuarial standards of practice and is clear and appropriate to the circumstances and its intended audience—not advice tailored or massaged to the financial and/or political constraints of our clients or the plan sponsors of our clients.

Further, actuaries are certainly not reluctant to speak up. In addition, actuaries are not in any way trying to stifle debate about the growing shortfall in fund assets. In fact, the Actuarial Standards Board (ASB) created a Pension Task Force (PTF) in December 2014 for the purpose of considering the standards implications of many proposals for change related to public pension plans that the ASB has received over the past few years. The input considered by the PTF included, among other items: (1) recommendations/reports/articles pertaining to public plan funding from the Conference of Consulting Actuaries (CCA), American Academy of Actuaries (AAA), California Actuarial Advisory Panel (CAAP), Society of Actuaries (SOA) Blue Ribbon Panel and Government Finance Officers Association (GFOA); (2) responses to the ASB's "Request for Comments-ASOPs and Public Pension Plan Funding and Accounting," issued in July 2014; and (3) testimony provided at the ASB's July 2015 hearing on public pension plans. Based on its review the PTF suggested potential changes for consideration by the ASB. After extensive discussion of these suggestions the ASB directed its Pension Committee to draft appropriate proposed modifications to the pension Actuarial Standards of Practice (ASOPs), based on the suggestions of the PTF. The proposed changes to the ASOPs are part of a larger, ongoing, effort by the ASB in recent years to strengthen pension-related ASOPs.

I realize that the article titled, "Covering up the Pension Crisis" is merely an opinion piece, so Malanga can take some liberties with the facts. However, I believe that readers of this article would have been better served if *The Wall Street Journal* had also included in the same issue a counterpoint from actuaries who are well-versed in the intricacies of public pension plan finance. Further, I believe that Malanga's inflammatory rhetoric

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does nothing to help solve the problem of public pension plan underfunding.

In addition to the arguments voiced in Malanga's opinion piece, another common reason given for the use of a market-based measurement of pension liabilities is the lack of meaningful disclosure regarding the value of state or local government employee pension benefit plan assets and liabilities. This lack of meaningful disclosure supposedly impairs the ability of state and local government taxpayers and officials to understand the financial obligations of their government, and reduces the likelihood that state and local government processes will be effective in assuring the prudent management of their plans. In fact, in the preamble to the release of GASB Statements 67 and 68, GASB chairman Robert H. Attmore stated on June 25, 2012, "The Governmental Accounting Standards Board (GASB) today voted to approve two new standards that will substantially improve the accounting and financial reporting of public employee pensions by state and local governments. The new standards will improve the way state and local governments report their pension liabilities and expenses, resulting in a more faithful representation of the full impact of these obligations."

In its preliminary views document published in June 2010, the GASB considered, but rejected, the market-based measure methodology for valuing future liabilities, stating, instead, that the interest rate used should be a reasonable estimate of the rate at which plan assets are expected to grow as a result of investment earnings. Paragraph 228 of GASB Statement No. 68 describes the rationale for this conclusion, "The Board believes that the approach required by this Statement—which incorporates projections of future cash inflows from pension plan investment earnings into the measurement of service cost and the total pension liability—is consistent with its views related to the projection of benefit payments, in which all reasonably anticipated future events are incorporated into the estimate of the total obligation that will be incurred by the employer over the course of an employee's career. The amounts that are projected to be provided by pension plan investment earnings represent a reduction in the employer's expected sacrifice of resources to satisfy the obligation for pensions. Therefore, if the potentially

significant effect of pension plan investment earnings is not considered in the measurement of the pension liability, the Board believes that amounts recognized by the employer, including the employer's cost of services associated with pensions as they are earned, potentially would be misstated and would fail to provide information appropriate for use in assessing the degree to which interperiod equity is achieved."

In summary, while not perfect, GASB Statements 67 and 68 do require disclosures that result in a more complete representation of the full impact of public pension obligations. This includes anticipation of "the effect of pension plan investment earnings."

So, now on to what I consider to be the real essence of the issue—whether a disclosure of pension liability based on a market-based measure adds any meaningful value—in addition to the disclosures already mandated by GASB Statements 67 and 68. To answer this question, let's put aside the same old "Market Value of Liabilities" and "Financial Economics" arguments for a moment and, instead, focus on the big picture. For example, according to Section 2, Paragraph 8 of the Public Employee Pension Transparency Act (H.R. 4822), introduced on March 21, 2016, (commonly referred to as PEPTA), the present value of the already promised pension liabilities of the 50 states and major municipalities, calculated using a market-based measurement, is $7.0 trillion with unfunded liabilities at $3.4 trillion. Also, according to this same paragraph of PEPTA, the present value using the methodology prescribed by GASB is "only" $4.8 trillion with unfunded liabilities of $1.2 trillion. (Note: it appears these figures were taken from a Hoover Institution Essay written by Joshua D. Rauh titled, "Hidden Debt, Hidden Deficits—How Pension Promises are Consuming State and Local Budgets.")

Now, while the unfunded liability amounts calculated under a market-based measurement ($3.4 trillion) are substantially higher than those reported by pension funds using the GASB requirements (only $1.2 trillion), is the conclusion really any different? If the value of unfunded liabilities is $1.2 trillion or $3.4 trillion, does that change the overall conclusion that we have a major pension funding crisis that needs attention now? In other words—isn't an unfunded liability of $1.2 trillion large enough to make the point that public pension underfunding is a significant issue that needs to be addressed? If the underfunding was pegged at $3.4 trillion, would the conclusion change? I certainly don't think so!

Mounting public-sector retirement costs is clearly an issue for a number of state and local governments. Unfortunately, the current funding issues facing public pension systems are complicated and multifaceted, and there is no simple strategy for dealing with them. However, I strongly believe that the current focus on the question of what is the "right" measure of pension liabilities is misguided and actually distracts everyone from addressing the real critical issue facing public pension plans today—the need for improved public plan funding. In some respects I believe this misguided focus also allows decision makers/plan sponsors and legislators the opportunity to defer making important decisions about pension plan funding until the "right" measure of pension liabilities is settled.

In her testimony to the PTF, Ms. Bailey Childers, executive director of the National Public Pension Coalition, which represents teachers, nurses, firefighters, and others who rely on public pensions, testified that, while some public plans are in poor fiscal condition, that situation is almost always due to systemic budgetary problems or a lack of funding discipline and not erroneous actuarial assumptions. I completely agree with Childers' conclusion. Actuaries cannot craft laws requiring actuarially-based funding for public pension plans, and governments don't always contribute what the actuary calculates.

Solving the public pension funding crisis requires prompt action. Unfortunately, there is no "silver bullet" for solving the public pension crisis. Public officials must confront runaway public pension and retiree health benefit costs or risk voter backlash, as these costs hit taxpayers in the pocketbook and force states to spend tax dollars on legacy obligations that, otherwise, could have been used for education, services and infrastructure. A former Illinois Governor in his annual budget address warned, "Unless we reform the way we fund our pensions . . . we will never eliminate the structural deficit that takes money away from education, from health care, from law enforcement, from parks, and from everything else we care about." Unfortunately, this will require strong political leadership and the willingness to confront entrenched interests.

Jurisdictions must develop fiscally sound funding policies for their public pension systems and then have the discipline to follow them. Officials must make the required pension contributions when times are tough. Just as important, they must resist politically expedient pension giveaways when times are good. In addition, once these policies are set, they must be reviewed periodically to ensure they remain appropriate.

In summary, I believe the public would receive more value if, instead of just focusing on the very narrow issue of what is the "right" measure of pension liabilities, everyone, instead, focused on actions that can be implemented to encourage actuarially-based funding of public pensions. This is the issue on which we all should be spending our time and knowledge—in order to provide our hard working public employees with a sound and secure retirement benefit. ■

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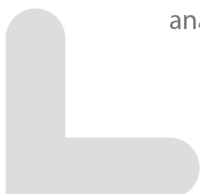

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