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ROAD TO IMPROVE PUBLIC PENSION FUNDING

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Many outside of the public pension arena, including insurance company actuaries, often misunderstand how the role of a consulting public plan actuary differs from the role of an insurance company actuary. The work of the SOA Blue Ribbon Panel provides several examples of this misunderstanding. The chairperson of the Blue Ribbon Panel said that the principal power in governance is the actuary. While that may be true in the insurance industry, it is certainly not the case for public pensions, and I suspect it is not the case for Social Security. However, the opinions of public plan actuaries do have some influence.

Some of the SOA Blue Ribbon Panel recommendations were good, but some showed a misunderstanding of the role of the actuary and also a misunderstanding of the role of the Actuarial Standards Board (ASB). The Panel asked that ASB adopt their policy recommendations. I'll consider four of the recommendations:

1. Funding the actuarially recommended contribution: This clearly is not within the control of the actuary. This is a policy judgment made by elected officials. We may believe politicians are short sighted if they choose to hire more police officers rather than properly fund pensions. However, this requirement to properly fund the plan cannot be an actuarial standard set by ASB.

2. Use Entry Age Normal as the funding method: Again this might be a best practice in most cases but the ASOPs do not set best practices. If we make this a requirement, how do we explain why FASB's Projected Unit Credit (PUC) is bad when it is not? Why ERISA plans use unit credit? How unit credit might be far superior for a variable annuity plan even in the public sector? Certainly some methods are prescribed, but there are many questions about why a particular method would be set as a minimum standard. Pension actuaries familiar with working with these different methods may be better apt to understand these differences than insurance actuaries.

3. Use of median investment returns expectation: I believe this is also a best practice. However, why is the mean return unacceptable and, as with PUC, also a required FASB basis? Could ASB make this best practice a minimum standard? Yes, but the Panel did not present a full case.

4. Solvency supremely more important than level budgeting: This is what I believe to be the largest difference between public pension plans and the insurance industry. The "premium" source for public plans is not as limited as in the insurance industry—though it does have limits. The amount of resources to be allocated to public plans is a political decision, not an actuarial decision. Historically, level budgeting has been more important to governments. I believe plan solvency may deserve more attention than it has been given historically, but the Panel leans too far in that direction at the sacrifice of level budgeting.

The draft of the risk ASOP defines Risk Appetite as "The level of aggregate risk that an organization chooses to take in pursuit of its objectives." The plan sponsor, not the actuary, gets to make this decision. It is not our role to make this decision; it is our role to help sponsors understand the current and future risks. However, there is no free and easy way to do this. I asked the Illinois Department of Insurance to provide the likelihood that an insurance company would become insolvent. I did not expect an answer and I did not get one. Would it be

valuable to know? Yes. Is the information easy to get and something everyone wants to share? No.

If an actuary is an advisor, how can we strengthen these systems when the plan sponsor makes the decisions? The lack of regulation cannot be filled by ASB. ASB can help in some areas but will not be able to fix things like "fund the Actuarially Required Contribution." I suggested to the Blue Ribbon Panel that they recommend drafting model funding and governance language to be adopted by the states just as the NAIC does for insurance. The Panel decided to focus on the ASOPs instead. I don't think model language should look like the insurance rules and I don't think drafting language will be easy to create. It is one thing to write rules to regulate others as the NAIC does for insurance companies. It will be even more challenging for governments to write regulations for themselves.

The Public Plans Community of the Conference of Consulting Actuaries (CCA) has strengthened practice by publishing a White Paper on public plan funding that is directed not only to actuaries but also to plan trustees and plan sponsors. I would like to see public pension actuaries promote this type of analysis and I hope more actuaries, especially those in the insurance industry, embrace my suggestion of model governance language for states to adopt. As we move forward, we need to recognize that all areas of actuarial practice are unique and face different challenges.

Does the ABCD have a role in improving public pension plan funding? While I have served on the ASB Pension Committee, I do not have firsthand experience as a part of ABCD. The one experience I did have with ABCD involved actuarial opinion shopping. I thought ABCD should have taken action. The ABCD can and should do more in this area while still allowing reasonable differences in opinion.

Public pension actuaries need to be central to the solution when it comes to rewriting ASOPs and trying to narrow practice (including things like use of old mortality tables) and actuary shopping. Non-pension actuaries can participate, but they need to understand the differences between pensions and insurance. ■