AMERICAN ACADEMY *of* ACTUARIES

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August 28, 2014

David R. Bean
Director of Research and Technical Activities
Project No. 34-1NTP
Governmental Accounting Standards Board (GASB)
401 Merritt 7, PO Box 5116
Norwalk, CT 06856-5116
director@GASB.org

Re: Exposure Draft on *Accounting and Financial Reporting for Pension Plans That Are Not Administered through Trusts That Meet Specified Criteria, and Amendments to Certain Provisions of GASB Statements 67 and 68*

Dear Mr. Bean:

The American Academy of Actuaries[1] Public Plans Subcommittee appreciates the opportunity to submit comments on the Exposure Draft on the *Accounting and Financial Reporting for Pension Plans That Are Not Administered through Trusts That Meet Specified Criteria and Amendments to Certain Provisions of GASB Statements 67 and 68.* We recognize and appreciate the thorough process GASB has followed to develop the Exposure Draft, including the prior work developing GASB Statements 67 and 68. Our comments focus on a couple of issues where we believe the Exposure Draft could be enhanced to better meet the objectives, concepts and principles established by GASB.

Our comments on the Exposure Draft contain the following two suggestions : The first pertains to a suggested additional required disclosure for plans not administered through a trust, and the second suggests an additional amendment to GASB Statements 67 and 68.

Disclosure Suggestion: Ten-Year Benefit Projection
For pension plans that are not administered through trusts, the pay-as-you-go benefit payments can increase rapidly due to retirements. Consequently, we suggest that the *Notes* to the financial statements include a disclosure of the projected benefit payments for current members for the next ten years. This disclosure would allow users of the financial statements to gain a better understanding of the requirements the pension plan imposes on the sponsor's finances. As these benefit payments are for current members only, in many cases the information is developed as a part of the actuarial valuation and can be disclosed with no additional work. For some cases, primarily small plans where a simplified valuation method may be used, additional work may be required. We do not

[1] The American Academy of Actuaries is an 18,000-member professional association whose mission is to serve the public and the U.S. actuarial profession. The Academy assists public policymakers on all levels by providing leadership, objective expertise, and actuarial advice on risk and financial security issues. The Academy also sets qualification, practice, and professionalism standards for actuaries in the United States.

recommend disclosure for significantly longer periods as these projected benefit payments do not include the impact of future hires and would likely understate actual future benefit payments.

Suggested Amendment to GASB 67 and 68 to Limit Contributions Used to Determine the Discount Rate

Overview of Issue

Paragraphs 40-45 of GASB 67 and paragraphs 26-31 of GASB 68 provide guidance on the calculation of the discount rate. In reviewing the exposure drafts for other postemployment benefits (OPEB) accounting and financial reporting, we noted that the same methodology is used, and we have raised some potential issues that are particularly related to common situations for partially funding OPEB plans. While the situation is significantly more common with OPEB plans, similar situations can arise with pension plans. The current language will result in a discount rate equal to the long-term rate of return on assets in some cases where benefits are being substantially financed by government contributions and not by investment earnings on those contributions. We understood from the basis for conclusions in GASB 68 paragraphs 226 through 231 that the use of the long-term rate of return as the discount rate was predicated on the plan accumulating assets and earning investment returns before paying out benefits.

Consider, for example, a plan with a nominal amount of assets in a trust and the sponsor consistently contributes an amount equal to the benefit payments for the year. The nominal amount of assets earns the long-term expected return, but the contributions are effectively used immediately to pay the benefits and do not get the benefit of investment returns. Under the current description of the methodology to calculate the discount rate, such a funding strategy would not have a crossover date and would use the long-term expected return as the discount rate. This result appears to contradict the intent expressed in the basis for conclusions of what the discount rate should represent.

Recommendation

Given an objective of preventing the use of a discount rate equal to the long-term expected return when assets are not actually expected to accumulate significantly in advance of paying the benefits, we recommend GASB develop appropriate additional parameters to the crossover test while retaining the basic structure established in GASB 67 and 68. We offer our assistance in developing these parameters and exploring approaches that might work (a few outlined below), but additional research would be required before we could make a detailed recommendation on specific parameters or even a general approach.

Option 1

One approach would be to limit the rate of contribution growth that could be considered in the crossover test. A strict limit equal to the rate of assumed payroll growth is too strict to accommodate contribution-smoothing techniques that are typical with actuarially determined contributions. Limiting contribution growth rates to the rate of payroll growth after a period of 5 to 7 years, however, would allow for most contribution-smoothing techniques while limiting the back loading of contributions that occurs with pay-as-you-go and similar funding strategies that do not accumulate significant assets before benefits are paid. We note that plans following a layered amortization for funding could still run into issues with this rule for periods where they had actuarial gains followed by actuarial losses.

Option 2

A second approach would be to require benefit payments, prior to the accumulation of assets equal to some multiple of benefit payments (e.g., 7), to be discounted at the municipal bond rate. So, for example, if benefit payments were $100 for the first year, they could not be discounted at the long-term expected return unless there was at least $700 in assets in the trust. Once this threshold was achieved, all future benefit payments could be discounted at the long-term expected return until a crossover date. This limitation is intended to require that a plan has significant assets earning an investment return before benefit payments can be discounted at the long-term expected return.

The difficulty with this approach is determining a reasonable multiple of benefit payments to use as a threshold. One possibility is to determine the amount of assets required such that investment returns would be expected to pay, for example, 50% of each year's benefit payments. If the long-term expected return is 7.00%, the trust would need assets approximately equal to 7 times benefit payments to be expected to earn half of the benefit payments in investment earnings (e.g., 7.00% x $700 = $49, which is slightly less than half of the $100 in benefit payments used in the example above).

Option 3

A third approach would be to state that an amount equal to the service cost for future employees should be subtracted from the total projected future contributions for purposes of the crossover test. Paragraph 27 of GASB 68 states that contributions "intended to finance the service costs of future employees" should be excluded from the crossover test. If the sponsor is making contributions based on the pay-as-you-go costs (perhaps plus a nominal amount), none of the contributions are intended to finance service costs, so they may reasonably interpret the standard to include all of these contributions in the crossover test. We suggest that for purposes of the crossover test, the contributions should first be deemed to be intended to finance the service costs of future employees, so this amount would need to be subtracted from the total contribution amount. This interpretation would be in keeping with the interpretation that statutory contribution rates are first intended to finance the service costs of future employees.

We hesitate to endorse any of these options because we have not had sufficient time to test them in a variety of situations to ensure they produce the desired results for pension plans. Instead, we offer to work with GASB to develop and refine an approach if any of these methods or other alternatives would better meet GASB's objectives related to the discount rate.

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We appreciate the opportunity to submit comments on the Exposure Draft on the Accounting and Financial Reporting for Pension Plans That Are Not Administered through Trusts That Meet Specified Criteria and Amendments to Certain Provisions of GASB Statements 67 and 68. If you have any questions or need further information, please contact Matthew Mulling, Pension Policy Analyst (mulling@actuary.org; 202/223-8196).

Sincerely,

William R. Hallmark, MAAA, ASA, FCA, EA
Chair, Public Plans Subcommittee
American Academy of Actuaries