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House Bill 1215

(As Engrossed February 6, 2015)
Actuarial Cost Study prepared for
Joint Committee on Public Retirement and Social Security Programs
of the Arkansas 90th General Assembly

Provisions of the Bill

House Bill 1215 affects all of the Arkansas state-supported retirement systems and all public employee retirement systems of political subdivisions of the state.

Arkansas Code Annotated §24-1-102 provides general language requiring the state supported public retirement plans to complete annual actuarial valuations. The section also provides that the actuary to this committee review and report the level of agreement with the methods and assumptions used in those actuarial valuations. In practice, this committee has not asked our firm to complete such reviews of methods and assumptions used by the systems.

House Bill 1215 adds a new subsection that requires an additional calculation and disclosure of an Unfunded Actuarial Accrued Liability amount using an investment assumption of 4%. The bill does not note whether it expects all other assumptions and methods to remain the same as the those used elsewhere in the valuation report. This disclosure is to be made in the same actuarial report "on the same page or following page."

House Bill 1215 also extends the coverage of this section of Code to all public employee retirement systems of political subdivisions of the state. Many of the smaller municipalities in Arkansas have elected coverage under APERS, but there are several larger municipalities that sponsor local defined benefit pension plans. There are also several municipally owned utilities that sponsor their own defined benefit pension plans. To the best of our knowledge, all of these municipal sponsored plans perform annual valuations, but do not have the 4% disclosure discussed. The closed, locally sponsored fire and police plans (covering those employed before 1983) are also all valued on an annual basis.

Fiscal Impact

The primary cost impact of House Bill 1215 would be the administrative expense associated with the additional actuarial calculations. Each system's actuary would have to make an additional calculation and then include the appropriate discussion of the meaning and the purpose of the additional measurement (see discussion of Actuarial Standards of Practice). If the committee desired a more formal review of methods and assumptions of each plan, there would additional costs for the committee and for each plan, including the plans sponsored by political subdivisions.

A possible unintended effect could arise if the additional disclosure was somehow construed to be the more appropriate measurement for long term funding. This could create political pressure on boards to lower the investment assumptions for funding purposes which would increase the costs to the systems. Additional disclosures can be instructive, but any disclosure should be carefully focused on a defined purpose or unintended results may occur. This point should be clearer after a discussion of Actuarial Standards of Practice and GASB 67 and 68.

Actuarial Standards of Practice

The actuarial profession has promulgated an extensive group of Actuarial Standards of Practice (ASOP or Standards). These standards are not written as a cookbook of formulas, but to provide guidance to actuaries when performing certain actuarial services. These serve to define certain commonly used actuarial terms and discuss issues that actuaries should consider when performing their work. In particular, when performing an actuarial valuation of a defined benefit pension fund, an actuary must keep in mind several of the ASOP: Measuring Pension Obligations (ASOP No. 4), Selection of Economic Assumptions for Measuring Pension Obligations (ASOP No. 27), Selection of Demographic and Other Noneconomic Assumptions for Measuring Pension Obligations (ASOP No. 35), and Asset Valuation Methods for Measuring Pension Obligations (ASOP No. 44). The general standards in Data Quality (ASOP No. 23) and Actuarial Communications (ASOP No. 41) should also be considered. The actuarial profession has extensively updated these standards in the past few years. One consequence of these changes is that, beginning this year, the reader will see more discussion of actuarial assumptions and methods in a valuation report than in the past.

The discussion of these Standards as part of an analysis of House Bill 1215 is to show that there are requirements in place to appropriately consider how methods and assumptions are set. All of these Standards discuss the need to articulate the purpose of the measurement. The Standards recognize that a regulatory board or law may prescribe certain assumptions. If the purpose of the prescribed investment assumption in House Bill 1215 is to show the risks of not attaining the funding investment assumption, then our recommendation would be to disclose this purpose and to report the results in a separate section of the report.

Governmental Accounting Standards Board, Statements 67 and 68

The Governmental Accounting Standards Board has recently issued Statements 67 and 68. These are often referred to as GASB 67 and GASB 68. These statements describe how a governmental entity reflects the liability and the expense related to defined benefit pension plans. These new statements will be reflected in the Comprehensive Annual Financial Report (CAFR) for the state beginning this year, and the expense items of GASB 68 will be reflected next year. All other entities that produce audited financial statements that comply with GASB will have to reflect these new Statements. The political subdivisions that are audited by Legislative Audit are completing a regulatory audit and will therefore reflect part, but not necessarily all, of the provisions of GASB 67 and 68.

A financial statement that is in compliance with GASB 67 and 68 will have several new disclosures beginning this year. There is extended discussion required about certain assumptions and methods used in making the calculations for GASB purposes. In particular, the notes to the financial statement will need to show the expected diversification of the portfolio and the expected returns associated with those classes of assets. There needs to be a demonstration that the funding plan, together with the assumed investment returns, will be able to provide the projected benefits. If this is not the case, the investment assumption is modified to reflect the borrowing rates for governmental entities for the portion of projected benefits not covered. Finally, the actuary must show the unfunded accrued liability (Net Pension Liability in GASB terms) if the discount rate used is 1% higher and lower than the assumed rate.

The calculations for GASB purposes are found in a different section of the same report as the valuation or sometimes in a separate report. This is because these calculations are for a different purpose than those calculations for funding. This again points out the need for clearly stated purposes for various measurements and the need to not communicate these on the same page. It would be appropriate, if the calculations were desired to put them in a separate section that discusses the risks of different investment returns and show the effects of a different rate or rates.

Disclosure of Interests

Osborn, Carreiro & Associates also serves as the actuaries for the Arkansas Fire and Police Pension Review Board. We also provide actuarial services to several municipalities and public utilities that would be affected by this bill.

Sincerely,

Jody Carreiro

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Actuary