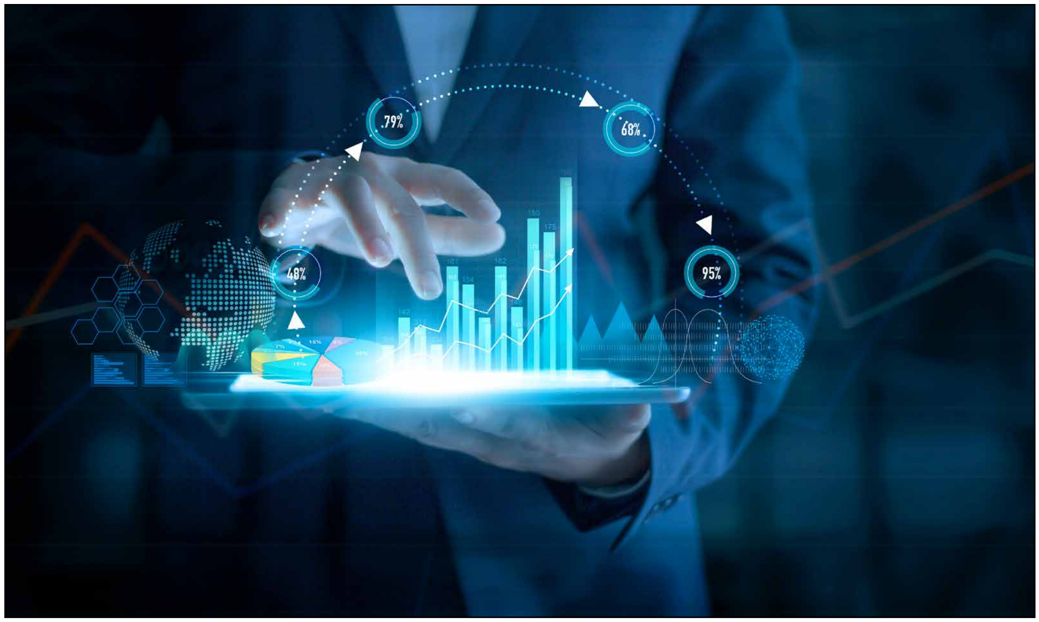
Revisions to Actuarial Standard of Practice No. 4 Expand Disclosure Requirements for Public Pension Plan Valuations

By: Brad Ramirez



In December 2021, after three rounds of exposure drafts and stakeholder commentary, the Actuarial Standards Board finalized and adopted changes to an Actuarial Standard of Practice (ASOP) called ASOP No. 4, *Measuring Pension Obligations and Determining Plan Costs or Contributions*. ASOP No. 4 adds significant disclosure requirements for all actuarial valuations issued on or after February 15, 2023.

What Are ASOPs?

ASOPs are the professional guidelines that govern work done by actuaries. The self-governed Actuarial Standards Board issues them after seeking input from practicing actuaries. Actuaries are required to follow ASOPs as part of membership in professional organizations, such as the Society of Actuaries and the American Academy of Actuaries.

Which New Disclosure Requirements Are Notable?

Some new disclosures relate to calculating a "reasonable" actuarial determined contribution (regardless of whether it was actually contributed) and related assessments of actual contributions. A particularly conspicuous change is a requirement to calculate and disclose a new market-based liability measurement called the Low-Default-Risk Obligation Measure (LDROM).

Under the revised ASOP, the LDROM may be determined in a manner similar to the Actuarial Accrued Liability (AAL) that's commonly used in public sector plan funding, but with a key difference: instead of basing the discount rate on the plan's expected rate of return (as is done in determining the AAL), the LDROM must use discount rates derived from "low-default-risk fixed income securities." Examples of these rates include U.S. Treasury yields and yields on high-rated corporate or tax-exempt general obligation municipal bonds.

Conceptually, when determined using the same AAL basis as used for funding, the LDROM represents what a plan's funding liability would be if the plan invested entirely in low-default-risk fixed income securities. For that reason, in most cases, the LDROM will be significantly higher than the funding AAL, simply because most plans are invested in assets with higher expected returns than a bonds-only portfolio.

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An important note is that the LDROM **will only be required as a disclosure item.** Public plans will continue to use the AAL for funding in accordance with existing policies.

Supporters of the LDROM claim that this disclosure will present to the public a more accurate measure of plan liabilities.

What Are the Concerns About LDROM?

Critics of the LDROM have long opposed mandatory disclosure of market-based liability measures for public pension plans. Some of the criticisms that were raised during the comment periods for the ASOP No. 4 revisions include:

- The measure is not relevant and/or useful to public pension plan funding.
- Calculations of risk-related disclosures, such as the LDROM, are already governed by *ASOP No. 51, Assessment of Disclosure of Risk Associated with Measuring Pension Obligations and Determining Pension Plan Contributions*, so a new specific measure isn't needed.
- The LDROM measure could cause public confusion, especially if it's used to mischaracterize the financial standing of public sector plans.

Potential Application for the LDROM

ASOP No. 4 also states that the actuary should provide commentary to help the intended user understand the significance of the LDROM with respect to the funded status of the plan, plan contributions and the security of participant benefits. One viable interpretation of the relationship between the LDROM and the funding AAL is that the difference between the two values shows the expected reduction in the taxpayer's funding liability from having the plan's assets invested in a diversified investment portfolio.

Public plans will have significant flexibility in how and where this measure is disclosed. Consequently, pension plan sponsors should discuss with their actuaries how to satisfy these requirements well before the implementation date so that the public will have a clear understanding of what the LDROM does — and does not — represent. ◆