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DISCUSSION DRAFT

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● DISCUSSION DRAFT ●

**Assessment and Disclosure of Risk
Associated with Pension Obligations,
Plan Costs, and Plan Contributions**

**Developed by the
Pension Committee of the
Actuarial Standards Board**

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TO: Members of Actuarial Organizations Governed by the Standards of Practice of the Actuarial Standards Board and Other Persons Interested in Assessment and Disclosure of Risk Associated with Pension Obligations, Plan Costs and Plan Contributions

FROM: Pension Committee of the ASB

SUBJ: Discussion Draft, *Assessment and Disclosure of Risk Associated with Pension Obligations, Plan Costs, and Plan Contributions*

This document contains a discussion draft of potential language that could ultimately be included in a proposed new ASOP, *Assessment and Disclosure of Risk Associated with Pension Obligations, Plan Costs, and Plan Contributions*. The purpose of this discussion draft is to share a portion of that work in order to collect input from interested parties as the Pension Committee of the ASB continues drafting the standard. Please note that since this is a work in progress, many changes and additions are likely.

The ASB has neither reviewed nor approved this discussion draft. This is not an exposure draft and there is no particular deadline for comments. However, the Pension Committee is proceeding apace on this project, so earlier comments are more likely to affect the contents of the eventual exposure draft. Your feedback on this project is important to us. The Pension Committee would like to receive your comments by September 30, 2012.

The Pension Committee may create an exposure draft that would draw on the ideas in this discussion draft, modified by discussions with and comments received from interested parties and unfolding events. The exposure draft would go through the normal ASOP process as follows:

1. The Pension Committee will submit the Exposure Draft (ED) to the ASB.
2. The ASB revises the ED as necessary and releases it to all actuaries and other interested parties for comment.
3. Following the end of the exposure period, the Pension Committee revises the ED based on comments received and produces a proposed ASOP or a second ED (depending on the extent of changes). This document follows the same process as the original ED (and even if submitted as a proposed ASOP may be changed to a second ED by the ASB).
4. An ASOP will become effective only after final approval by the ASB.

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Background

As previously indicated in the January 2011 Discussion Draft for ASOP No. 4, *Measuring Pension Obligations and Determining Pension Plan Costs or Contributions*, the Pension Committee has been reviewing all of the pension-related standards and has been working on potential guidance regarding the assessment, disclosure and management of pension risk as part of the larger review project. The Committee believes that a new standard should be considered, with such standard to provide guidance on assessment and disclosure of pension risk. However, the Committee believes that issuing guidance with respect to management of pension risk is not appropriate at this time.

Section 3.4.1 of ASOP No. 41, *Actuarial Communications*, indicates that “the actuary should consider what cautions regarding uncertainty or risk in any results should be included in the actuarial report.” Section 3.3.3 of the exposure draft of revised ASOP No. 4 says, “Consistent with section 3.4.1 of ASOP No. 41, the actuary should consider the risk or uncertainty inherent in the measurement assumptions and methods and how the actuary’s measurement treats such risk or uncertainty.”

Section 3.15 of current version of ASOP No. 4 (and of the exposure draft of revised ASOP No. 4) provides guidance to an actuary whose assignment includes an analysis of the potential range of future pension obligations, costs, contributions or funded status. Section 4.1(l) of the existing standard (4.1(q) of the exposure draft) requires disclosure that future pension measurements may differ significantly from current measurements, possibly resulting from a number of factors. This section also requires the actuary to provide results of the analysis of the potential range of future pension obligations, etc. if the scope of the actuary’s assignment included such analysis, or a statement indicating that because of the limited scope of the assignment, such an analysis was not performed.

The Pension Committee believes that additional guidance that expands on section 3.4.1 of ASOP No. 41 and section 3.3.3 of the ASOP No. 4 exposure draft would be helpful. Additionally, the Pension Committee believes that providing additional disclosures would help the intended users of the actuarial findings to have a better understanding of risks inherent in measuring pension obligations and determining plan costs or contributions. Given the significance of the new guidance anticipated by the Pension Committee, it feels that such guidance should come in the form of a new standard of practice that may replace some of the requirements set forth in existing standards.

The Pension Committee believes that the guidance provided in this potential ASOP should also apply to the measurement of retiree group benefit obligations and the determination of retiree group benefit plan costs or contributions. It also proposes to add cross references to this standard in both ASOP No. 4 and ASOP No. 6.

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The Pension Committee acknowledges that a standard that requires an actuary to assess and disclose pension risk for almost all pension measurements expands existing standards applicable to pension actuaries. The committee believes that this expansion may produce better, more transparent actuarial communications that will be valuable to users of the pension actuary's work product.

The Pension Committee does not believe that the assessment of risks anticipated by this new standard will require exhaustive analysis or sophisticated risk modeling tools. However, the Pension Committee does not want to discourage the use of more sophisticated approaches.

Request for Comments

The Pension Committee is releasing this discussion draft to provide members of actuarial organizations governed by the ASOPs and other interested parties an opportunity to comment. While all comments will be considered, the committee is particularly interested in the following questions:

1. Do you believe it is appropriate to require the actuary to assess and disclose pension risk for substantially all pension actuarial assignments? If so, do you believe that the approach in this discussion draft is appropriate? If not, what approach do you recommend?
2. Do you believe that the assessment of risk can be achieved solely through a narrative describing the risks or do you believe that some type of quantitative analysis is necessary to assess pension risk?
3. Section 3.2 identifies four specific risks to be assessed. Are these four specific risks the primary risks to assess? If not, what changes do you suggest?
4. ASOP No. 4 does not require the actuary to assess sponsor viability. This proposed standard is silent on the question. Should a risk standard specifically require the actuary to evaluate how sponsor viability might negatively impact a plan's financial condition, remain silent on the question (other than the open-ended section 3.2.5 of this discussion draft), or take the approach used for ASOP No. 4? Why?
5. Would the language in the discussion draft provide sufficient guidance to actuaries performing risk assessment work? If not, what additional guidance should be provided?
6. Is the language in the discussion draft sufficiently flexible to allow for new developments in this newer area of actuarial endeavor?

Please review this discussion draft and give the Pension Committee the benefit of your comments and suggestions. Comments will not be posted to the ASB website and will not

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receive individual responses; however, they all will receive appropriate consideration by the Pension Committee in preparing the exposure draft for approval by the ASB. Comments can be sent to discussion@actuary.org. **Comments will be reviewed as they are received, but the Committee plans to move forward based on comments received by September 30, 2012.**

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If you wish to use conventional mail, please send comments to the following address:

Pension Risk Discussion Draft
Actuarial Standards Board
1850 M Street, Suite 300
Washington, DC 20036

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Pension Committee of the ASB

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The ASB establishes and improves standards of actuarial practice. These ASOPs identify what the actuary should consider, document, and disclose when performing an actuarial assignment. The ASB's goal is to set standards for appropriate practice for the U.S.

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ASSESSMENT AND DISCLOSURE OF RISK
ASSOCIATED WITH PENSION OBLIGATIONS,
PLAN COSTS, AND PLAN CONTRIBUTIONS

Section 1. Purpose, Scope, Cross References, and Effective Date

- 1.1 Purpose—This actuarial standard of practice (ASOP) provides guidance to actuaries, when performing professional services with respect to measuring pension obligations and determining plan costs or contributions, with regard to the risks inherent in those measurements and determinations. Throughout this standard, the term *plan* refers to a defined benefit pension plan. Other actuarial standards of practice address measuring pension obligations, determining plan costs or contributions, selecting actuarial assumptions for measuring pension obligations, and selecting and using asset valuation methods for pension valuations.
- 1.2 Scope—This standard applies to actuaries when performing professional services with respect to the following tasks, in connection with a pension plan:
- a. measurement of pension obligations and plan funded status;
 - b. measurement of plan costs or contributions;
 - c. determination as to the types and levels of benefits supportable by specified cost or contribution levels; and
 - d. projection of pension obligations, funded status, plan costs or contributions, and other related measurements.

The term “measurement” as used herein refers to both specific determinations and estimations.

This standard does not apply to actuaries when performing professional services with respect to individual benefit calculations, individual benefit statement estimates, annuity pricing, nondiscrimination testing, and social insurance programs as described in section 1.2, Scope, of ASOP No. 32, *Social Insurance* (unless an ASOP on social insurance explicitly calls for application of this standard).

If the actuary departs from the guidance set forth in this standard in order to comply with

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applicable law (statutes, regulations, and other legally binding authority), or for any other reason the actuary deems appropriate, the actuary should refer to section 4.

- 1.3 Cross References—When this standard refers to the provisions of other documents, the reference includes the referenced documents as they may be amended or restated in the future, and any successor to them, by whatever name called. If any amended or restated document differs materially from the originally referenced document, the actuary should consider the guidance in this standard to the extent it is applicable and appropriate.
- 1.4 Effective Date—This standard will be effective for any actuarial work product with a measurement date on or after twelve months after adoption by the Actuarial Standards Board (ASB).

Section 2. Definitions

The terms below are defined for use in this actuarial standard of practice.

- 2.1 Risk—The potential of future losses or shortfalls from expectations due to deviation of actual results from expected results.
- 2.2 Scenario Test—A process for assessing the impact of several simultaneously occurring possible events on a plan's financial condition.
- 2.3 Stochastic Modeling—A process for determining a distribution of possible future outcomes either directly or through a model that calculates the impact of a deviation from a risk assumption on the plan's financial condition.
- 2.4 Stress Test—A process for measuring the impact of adverse changes in one or relatively few factors affecting a plan's financial condition.

Section 3. Analysis of Issues and Recommended Practices

- 3.1 Overview—Measuring pension obligations and determining plan costs or contributions require the use of assumptions regarding future events. Because future events are uncertain, such measurements and determinations are uncertain and expose multiple parties to risk.

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When performing an assignment covered by this standard, the actuary should include an assessment of the risks outlined in section 3.2. This standard provides guidance on conducting such assessments, as well as on related communications and disclosures.

In some circumstances, the actuary's assignment might include advising the plan sponsor on the management or reduction of risk; this standard does not provide guidance on such risk management.

Guidance regarding methods and assumptions for measuring and determining pension costs, contributions, obligations, and funded status is provided in 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*; and ASOP No. 44, *Selection and Use of Asset Valuation Methods for Pension Valuations*. In the event of a conflict between the guidance provided in this ASOP and ASOP No.4, this ASOP would govern.

- 3.2 Risks to be Evaluated—The actuary should evaluate the following risks in an assessment of the risks involved in measuring pension obligations and determining plan costs and contributions. The extent of the evaluation should be commensurate with the actuary's view of the significance of the specific risk.
- 3.2.1 Investment Risk—The risk that future investment returns will be different than expected and negatively affect the plan's financial condition. The actuary is not expected to provide investment advice.
- 3.2.2 Asset/Liability Mismatch Risk—The risk that changes in asset values will not be matched by changes in the value of liabilities, to the extent that the changes negatively affect the plan's financial condition.
- 3.2.3 Interest Rate Risk—The risk that unanticipated changes in interest rates will negatively affect the plan's financial condition.
- 3.2.4 Longevity Risk—The risk that unanticipated future changes in mortality will negatively affect the plan's financial condition.
- 3.2.5 Other Significant Risks—Any other risks that the actuary considers to have a potentially material negative effect on the plan's financial condition.
- 3.3 Assumptions for Assessment of Risk—In order to assess the effect of adverse experience

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on the plan, the actuary may need to model such experience by employing a range of assumptions that differ from the assumptions/methods used to determine expected results.

The assumptions used for assessment of risk may be based on economic and demographic data and analyses. This information is available from a variety of sources, including representatives of the plan sponsor and administrator, investment advisors, demographers, economists, accountants, and other professionals. The actuary may benefit from becoming familiar with a range of views on the factors underlying each assumption. Views of experts or principals may be considered but the selection of assumptions for the assessment of risk should reflect the actuary's professional judgment.

- 3.4 Methods for Assessment of Risk—The actuary should use professional judgment in selecting the appropriate methods for assessing each risk set forth in section 3.2. Methods may include, but are not limited to, stress tests, scenario tests, or stochastic modeling.

The actuary should consider the degree to which the methods and models reflect the nature, scale and complexity of the plan. Practical considerations include usability, reliability, timeliness, and cost efficiency.

Section 4. Communications and Disclosures

- 4.1 Disclosures—In addition to any relevant disclosures required under ASOP Nos. 4, 23, 27, 35, 41, and 44, actuarial communications covered by this standard should include descriptions of the following:

- a. the risks assessed
- b. the assumption ranges considered;
- c. the methods used to assess the risks; and
- d. the results of the assessment.

The results of the assessment should include a narrative description of each of the risks in section 3.2 and may include the following:

- a. a range, confidence level, or other statistical calculation; or
- b. outcomes of scenarios, possibly including extreme scenarios.

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An actuarial communication can comply with some or all of the specific requirements of this standard by making reference to information contained in other actuarial communications available to the intended audience (as defined in ASOP No. 41), such as an annual actuarial valuation report.

- 4.2 Deviation from Guidance in the Standard—If the actuary departs from the guidance set forth in this standard, the actuary should include the following where applicable:
- a. the disclosure in ASOP No. 41, section 4.2, if any material assumption or method was prescribed by applicable law (statutes, regulations, and other legally binding authority);
 - b. the disclosure in ASOP No. 41, section 4.3., if the actuary states reliance on other sources and thereby disclaims responsibility for any material assumption or method selected by a party other than the actuary; and
 - c. the disclosure in ASOP No. 41, section 4.4, if, in the actuary's professional judgment, the actuary has otherwise deviated materially from the guidance of this ASOP.