

## **FOURTH EXPOSURE DRAFT—August 2006**

### **Appendix 2**

#### **Comments on the Third Exposure Draft and Responses**

The third exposure draft of this proposed ASOP was issued in September 2005 with a comment deadline of February 28, 2006. Five comment letters were received, some of which were submitted on behalf of multiple commentators, such as by firms or committees. For purposes of this appendix, the term “commentator” may refer to more than one person associated with a particular comment letter. The Pension Committee carefully considered all comments received, and the ASB reviewed (and modified, where appropriate) the proposed changes. Summarized below are the significant issues and questions contained in the comment letters and the responses to each. The term “reviewers” includes the Pension Committee and the ASB. Unless otherwise noted, the section numbers and titles used below refer to those in the third exposure draft.

| <b>SECTION 1. PURPOSE, SCOPE, CROSS REFERENCES, AND EFFECTIVE DATE</b> |  |
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| <b>Section 1.4, Effective Date</b>                                     |  |
| Comment  | One commentator believed the effective date should be extended, preferably to one year after adoption.   |
| Response   | The reviewers extended the effective date from four months to six months after adoption to coordinate with the expected adoption of ASOP No. 4, <i>Measuring Pension Obligations and Determining Pension Plan Costs or Contributions</i> .   |
| <b>SECTION 2. DEFINITIONS</b>  |  |
| <b>Section 2.4, Market Value</b>                                       |  |
| Comment  | One commentator suggested that the definition be revised to capture the nuance that market value is not technically the price for which an asset might potentially be sold, but rather the price for which a security was sold, and then that price was used to value the asset of a third party holding a position in that same security.                                       |
| Response   | The reviewers reconsidered the definition and decided to modify it to be consistent with the definition of “fair value” in Statement of Financial Accounting Standards No. 157, <i>Fair Value Measurements</i> (September 2006).   |
| <b>SECTION 3. ANALYSIS OF ISSUES AND RECOMMENDED PRACTICES</b>         |  |
| <b>Section 3.2.2, Objectives of the Principal</b>                      |  |
| Comment  | One commentator suggested eliminating “a desire for stable or predictable contributions” as an example of an objective of the principal, noting that plan sponsors want flexibility.   |
| Response   | The reviewers made no change, believing that many plan sponsors are concerned about having stable and predictable contributions. For example, many public employee pension plans and multiemployer pension plans are interested in maintaining stable and predictable contributions. Moreover, the proposed standard offers this as an example of an objective of the principal. |

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| <b>Section 3.2.6, Additional Considerations</b>              |  |
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| Comment  | One commentator suggested inserting “measurement” after “obligation” in the phrase “the characteristics of the obligation.”  |
| Response   | The reviewers agreed and changed the wording in a similar fashion.   |
| Comment  | One commentator suggested revising the language to allow for the fact that the actuary may not know all “relevant factors” that may be important to the selection of an asset valuation method.  |
| Response   | The committee agreed and inserted “known” before “relevant factors.”   |
| <b>Section 3.3.1, Relationship to Market Value (now 3.3)</b> |  |
| Comment  | Two commentators wrote that if an asset valuation method satisfied either the requirement of section (b)(1), that the asset values fall within a reasonable range around the corresponding market values, or section (b)(2), that any differences between the actuarial value of assets and the market value are recognized within a reasonable period of time, it was unnecessary that it satisfy the requirement of the other section. One commentator asked why section (b) requires an asset valuation method to satisfy sections (b)(1) <i>and</i> (b)(2) and then seems to state in its final paragraph that an asset valuation method may satisfy either (b)(1) <i>or</i> (b)(2).   |
| Response   | The reviewers believed that a method generally should satisfy both requirements. The final paragraph in section (b) is intended to accommodate situations in which either the range around the market value is sufficiently small or the period of time over which differences between actuarial value of assets and market value are recognized is sufficiently short so as to make the other test largely irrelevant.  |
| Comment  | One commentator wrote that the example in section (b)(1), which includes a uniform corridor above and below market value, may not be appropriate. The commentator stated that it may be appropriate in some circumstances for an actuary to use a corridor that is not uniform, particularly one that makes the actuarial value of assets lower than market value. The commentator also wrote that section 3.3.2 (now 3.4.1) implies that an actuary may use an asset valuation method that has significant systematic bias and questioned why this section seems to restrict the actuary’s ability to select an asset valuation method that has significant systematic bias.  |
| Response   | First, the reviewers note that the corridor is intended only as an example. The reviewers also note that this section applies to actuaries when <i>selecting</i> , or giving advice on <i>selecting</i> , an asset valuation method, and current section 3.4.1 applies to actuaries when <i>using</i> an asset valuation method.<br><br>The reviewers believed that in some circumstances, an actuary who exercises professional judgment may conclude that an asset valuation method that has significant systematic bias is appropriate for the purpose of the measurement. The reviewers note that the actuary should disclose the use of an asset valuation method that has significant systematic bias in accordance with current sections 3.4.1 and 4.1.5. |
| Comment  | One commentator suggested that the reference to the “plan’s investment practice” be deleted from the last paragraph of this section, concerning the use of amortized cost for bonds and other income securities in certain situations, because it is unnecessarily restrictive. The commentator noted that an investment manager can trade securities within a portfolio without materially changing the expected cash flow and wrote that the proposed standard should not subject similar portfolios to different requirements solely because the individual securities in one portfolio are not intended to be held to maturity.  |
| Response   | The reviewers believed that the use of amortized cost should remain limited to situations in which securities are expected to be held to maturity.   |

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| <b>Section 3.3.2, Bias (now 3.4.1)</b>                  |   |
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| Comment   | <p>One commentator disagreed with the requirement that the actuary disclose that an asset valuation method has significant systematic bias, believing that a full description of the asset valuation method is sufficient for the user to determine if the method is biased.</p> <p>The commentator also suggested that, if this section were retained, it should be limited to those instances in which the actuary <i>believes</i> that an asset valuation method has bias, rather than those in which an asset valuation method <i>has</i> bias.</p> <p>Finally, the commentator believed that it is inappropriate for the proposed standard to require the actuary to disclose that a prescribed asset valuation method has bias, as it puts the actuary in a position of evaluating whether a legally required method has characteristics that could be considered undesirable by readers of the disclosure.</p> |
| Response  | <p>Regarding the first point, the reviewers did not believe that a full description of a biased asset valuation method is always sufficient for all potential users to recognize that the method has bias. Regarding the second point, the reviewers believed that the existing language, in which the determination of whether an asset valuation method has significant systematic bias is based on the actuary’s professional judgment, makes the addition of the word “believes” unnecessary. Regarding the third point, the reviewers note that the word “bias” is intended to be descriptive and not pejorative and that the existence of bias in an asset valuation method does not necessarily make the method an inappropriate method, given the purpose and nature of the measurement. Consequently, the reviewers made no changes.</p>   |
| Comment   | <p>One commentator wrote that the phrase “a series of changes in the asset valuation method” was vague. Another commentator thought that the example in section (b) was unclear.</p>  |
| Response  | <p>The reviewers deleted the phrase “a series of,” revised the example, and added a second example to clarify the meaning of the section.</p> <p>The reviewers also deleted the first example in section (c), because such an asset valuation method would not produce actuarial values of assets that bear a reasonable relationship to the corresponding market values as described in section 3.3.1 (now 3.3). Moreover, the reviewers did not want readers to misinterpret the example as a suggestion that the use of the lesser of the actuarial value of assets and the market value of assets in the calculation of the full funding limit was an asset valuation method, which was not the intent.</p>   |
| <b>Section 4.1.4, Prescribed Asset Valuation Method</b> |   |
| Comment   | <p>Two commentators opposed the requirement that the actuary disclose that, in the actuary’s professional judgment, an asset valuation method prescribed by the plan sponsor is not reasonable in light of the purpose of the measurement. One commentator wrote that the requirement places a higher standard on the actuary’s judgment.</p>   |
| Response  | <p>The reviewers believed that such a disclosure requirement is appropriate and necessary to prevent the actuary’s work from being misused. The reviewers believed that the disclosure requirement in the proposed revision of ASOP No. 4 regarding prescribed assumptions and methods should apply to asset valuation methods as well. Accordingly, the committee revised the section to refer to a similar disclosure requirement in the proposed revision of ASOP No. 4.</p>   |

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| Comment  | One commentator was concerned that this requirement to disclose would apply only to a plan sponsor but not a governmental or accounting body.  |
| Response | The reviewers believed that situations in which the plan sponsor exercised discretion were distinguishable from circumstances in which governmental or other entities exercised rulemaking authority with general applicability.         |
| Comment  | One commentator was concerned that this disclosure requirement could be part of a public communication (such as an attachment to a Schedule B) that could put the actuary in disagreement with his or her client.                        |
| Response | The reviewers believed that the disclosures required by the proposed standard could be contained in a cover letter, in an attachment to Schedule B, or in some other medium, depending on what is appropriate in the actuary's judgment. |