

Comment #2 – 3/23/15 – 12:58 p.m.

March 22, 2015

ASOPs – Assessment and Disclosure of Risk for Pension Plans
Request for Comments
Actuarial Standards Board
1850 M Street, NW, Suite 300
Washington, DC 20036-4601

Dear Actuarial Standards Board,

Thank you for the opportunity to offer comments with respect to the Exposure Draft of this new standard.

The Exposure Draft has many positive attributes and I commend the ASB for engaging in the challenging process of creating a new standard. I feel, however, that the exposure draft falls substantially short of best representing our profession and the public interest on several important dimensions.

Before detailing my thoughts, I should disclose my perspective. My perspective is that of a non-pension actuary (FSA, MAAA) and a public pension stakeholder. Specifically, I am a taxpayer and public pension plan participant in Illinois, a state with particularly challenged public pension plans and active public pension plan litigation. I am a health actuary who has invested considerable time and effort in studying public pension plan actuarial work and the applicable actuarial standards and in talking with and learning from pension actuaries.

My comments are with respect to the risk related to public pension plans. I don't necessarily know whether my comments are applicable to private pension plans and I am not, at this time, taking a position as to whether there should be separate actuarial standards for public and private pension plans.

The following are the areas where I believe that the Exposure Draft should be strengthened.

1. Definition of Pension Plan
2. Scope
3. Sponsor Funding Risk
4. Additional Measures of Plan Size
5. Risk Born by Participants

Definition of Pension Plan

I suggest that the definition of pension plan needs to clearly include all pension plans other than defined contribution plans – both defined benefit plans and hybrid plans. Section 1.1 defines a pension plan as a “defined benefit pension plan”. There is no further elaboration of the definition within the Section 2 definitions. My understanding is that under IRS code any pension plan that is not a defined contribution plan is, by default, a defined benefit pension plan. IRS code, however, is not applicable to public pension plans. Furthermore, in actuarial literature “defined benefit” typically refers

to plans where substantially all of the risk resides with the plan sponsor and plans that shift some, but not all, of the risk to participants are generically referred to as “hybrid” or “variable” plans.

Scope

As currently drafted the standard is only applicable when an actuary performs pension plan actuarial services with respect to measuring obligations and calculating contributions. This is, in my opinion, too narrow. Because it is challenging to imagine a pension assignment that should not involve a discussion of risk, I suggest that the scope definition should be expanded to include all assignments related to pension plans with the burden on the actuary who does not include at least a qualitative discussion of risk to document why risk is not relevant to the assignment or that the work involved would be onerous with respect to plan size.

There are other services commonly provided by pension plan actuaries that very much need to include at a minimum a qualitative discussion of risk. For example, the actuary may be providing advice concerning investment strategy, potential changes to a current plan, the design of a new hybrid plan, or the development of a contribution and funding strategy. Risk is integral to such assignments.

Pension actuaries are also sometimes involved in pension plan litigation. If we don't include litigation testimony under this standard, we cannot be assured that actuaries, in supporting the litigation interests of their principals, interests that may be advantaged by ignoring risk, will include a discussion of risk. For example, in 2014, while President of the Academy of Actuaries, Tom Terry prepared and filed an expert report with the Illinois Court on behalf of the Attorney General of Illinois that referred to fiscal year 2008 and 2009 market losses and their impact on Illinois public plans as “unexpected and devastating external circumstances”, “significant unexpected developments”, and “unexpected and unanticipated effects”. Tom did not include any discussion of the significant risk that is assumed by the State as a result of, then and now, investing 75% of plan assets in equities, derivatives, and real estate. (For an article concerning Illinois public pension plan risk, with comprehensive citations, including a link to Tom's report, is available at <http://www.wirepoints.com/risk-the-illinois-pension-devil-seldom-acknowledged-wp-guest/>.) When I asked him why he omitted to discuss risk, Tom told me that it was his obligation to vigorously support his client's interests (by omitting the discussion). His omission appears to be acceptable even under the proposed ASOP.

Sponsor Funding Risk

As currently drafted the actuary is not required to evaluate the ability of the plan sponsor to make contributions to the plan when due. While it is understandable that we don't expect actuaries to evaluate the financial and political risk associated with the sponsor making their contributions, I suggest that we have a responsibility to assure that sponsor risk is not overlooked.

Specifically, I suggest that:

- 1) The actuary who has not evaluated funding risk has to clearly state that he/she has not evaluated funding risk**

And that irrespective of whether the actuary has evaluated funding risk:

- 2) The actuary must disclose past any past underfunding (since past decisions are often indicative of future decisions),**
- 3) The actuary must disclose the potential for future underfunding whenever the plan sponsor has made public statements known to the actuary that indicate that future full contributions**

may not be made when due, including when governing statute sets the funding level at less than the full contribution level, and

- 4) The actuary must disclose the potential for future underfunding whenever future contributions are anticipated to increase at a rate faster than inflation.**

Funding risk is a significant risk for pension plans, particularly public pension risks. As a profession we market ourselves as risk experts. If we simply omit funding risk from our discussions and fail to mention clear signs of impending distress or underfunding, we discredit our profession. Disclosing that we have not evaluated funding risk while noting risk factors, requires minimal actuarial work and protects our professional reputation. There is precedence in the current ASOPs for requiring actuaries disclose when his/her work does not include certain analyses (example: ASOP 4, section 4.1.r.2).

Additional Measures of Plan Size

I suggest that plan size measures should include measures that compare the absolute size of the plan to the funding resources of the plan sponsor.

The current suggested list of measures for evaluating whether a plan is a “large plan” includes only absolute measures of participants, assets, and liabilities. While absolute size is important, so is relative size, particularly size relative to the plan sponsor’s revenue, tax base, and other means of funding the plan. For example, while a plan with \$1 billion in accrued liabilities is a large plan in the context of an Illinois local government, such a plan is a rounding error in the context of Illinois state government. The ASB could go a step further recommend a specific preferred “size denominator” that would allow for plan-to-plan relative size comparisons.

Risk Born by Participants

I suggest that the ASOP should require the assessment and disclosure of both sponsor and participant risk.

The proposed ASOP considers risk from the exclusive perspective of the plan sponsor. That’s acceptable for traditional defined benefit plans whereby substantially all of the risk resides with the plan sponsor. Hybrid plans and variable annuity plans that allocate/share risk between the plan sponsor and the plan participants, however, may be the future of public pension plans. I feel that in order to fulfill our responsibility to the public, we must discuss everyone’s risk, not just the plan sponsor’s risk. I recognize, however, that this would require a major change to the draft ASOP and therefore may be best considered as a potential future enhancement.

I hope that, at a minimum, my comments elicit thoughtful discussion.

Sincerely,

Tia Goss Sawhney
DrPH, FSA, MAAA