Comment #1 – 3/1/15 – 6:19 p.m.

Congratulations to the Pension Committee of the ASB for undertaking one of the most important initiatives ever in our profession – an ASOP on the assessment and disclosure of risk in pension plans. The exposure draft looks like an excellent step to move pension actuarial practice forward in this area.

Here are my comments (please preface each of these with “in my opinion”):

- The ultimate consequences that we are guarding against when we manage risk in pension plans are: 1) the loss of benefits by participants or 2) financial distress for the plan sponsor and their financial stakeholders. It may, in some situations, be appropriate for an actuary to comment separately and specifically on either or both of those two potential consequences.
- Q1 - The focus on funding valuations is appropriate but shouldn’t limit the actuary from doing similar assessments and disclosures for other work, including accounting valuations. In particular changes to a plan or to investment allocations might be occasions for disclosing risk information. While there should be a requirement related to funding valuations, an actuary should feel compelled, according to professional judgment, to suggest to a principal that information about risk be provided when otherwise warranted.
- Q4 - “Moderately adverse” seems like the wrong characterization. Good risk management does not result from looking at a potential range of results. Good risk management comes from focusing on potential bad outcomes and analyzing whether these outcomes are manageable if they arise, or avoidable - especially if they aren’t manageable, and then whether steps that may be taken to mitigate the bad outcomes are worth the cost. “Severely adverse” outcomes should be understood. “Plausible” seems like a reasonable criterion, but is it necessary to include this? Including both moderately adverse and severely adverse outcomes is appropriate.
- Q8 - The term “large plan” as it is used in the exposure draft is not quite right. Risk is higher when a plan is large relative to the financial resources of the plan sponsor. In those situations extra attention should be paid to risk assessment and disclosure. A plan sponsor that is not large enough to afford good risk assessment and disclosure, appropriate to their situation, should either not be sponsoring a plan or should be constrained in their approach to plan design and investments so that risk is manageable.
- 2.2 – “future NEGATIVE deviation”: add the word “negative”.
- 2.3 – should “financial position” be defined?
- 3.2 – all of the items listed are forms of asset/liability mismatch – it may be helpful to organize this list with that in mind
- 3.2 – The first sentence of the last paragraph is not appropriate. An actuary should at least qualitatively assess the ability of the plan sponsor to make contributions, and in particular, the potential for high funding requirements to occur when resources for funding are more strained – this is a critical element of risk management that actuaries of capable of contributing to. The actuary can use professional judgment in deciding whether there is a potential problem, but if there is a potential problem from the actuary’s perspective, it should be disclosed. We do not need to require quantitative analysis of this issue at this time, but such analysis should be encouraged.
- 3.4 - This list is good and the distinction between stress tests and scenario tests is particularly helpful.
3.6 – This concept and this list are useful information related to risk. Plan maturity introduces a kind of leverage (more risk relative to the productive resources of a plan sponsor) and it would be instructive to use the term “leverage”. It is not clear to me that 3.6.d (ratio of benefit payments to contributions) is a useful metric that is comparable across plans and across time; in particular there seems to be confusion in the profession and in the industry that there is some kind of tipping point that occurs when benefit payments are greater than contributions. Benefit payments to assets may be a useful ratio, and hopefully it is clear that the list provided is not exhaustive.

3.6 – Plan maturity is addressed, but, as described above (related to Q8), “plan affordability” (e.g., ratio of liability or unfunded liability to revenue) is extremely important; if we start to capture this information we, as a profession, will become more expert at understanding it and distinguishing problem situations from those that are not problems. At this point, the ASOP can simply suggest disclosure of this information.

3.7 – Appropriate risk assessment should be done as a matter of course – more often than every five years - at least every three years. It is not clear why multi-billion dollar financial institutions like many pension plans would not be doing continual, ongoing risk assessment that goes well beyond the disclosure identified in the exposure draft. That kind of risk assessment includes both the assets and liabilities, and therefore necessarily requires actuaries to be involved.

3.7 – As suggested above, the concept of a large plan should be in relation to the plan sponsors funding resources if the intention is that large plans pay extra attention to risk. If there are not enough financial resources to do risk assessment then constraints on asset/liability risk or on plan design should be encouraged or other retirement plan solutions should be sought. That might mean that some small plans with liabilities that are large in the context of their plan sponsor’s finances should change their risk management approach or their plan design or asset allocation significantly. Plans can also merge to gain greater scale. Those kinds of changes may take time, but the ASOP can encourage this rationalization.

Another useful concept for disclosure when expected returns are used as discount rates is to disclosure the difference between the pension liability with an expected return discount rate and a solvency market rate, divided by the solvency liability. This calculation provides an estimate of the risk in the asset allocation plus the risk in the estimate of the expected return. It would be a simple, but extremely useful metric for informed observers, providing a high level view of risk in the liability calculation for any plan.

These thoughts are respect fully submitted with high hopes that they are helpful to the Committee.

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