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May 8, 2015

Assessment and Disclosure of Risk
Actuarial Standards Board
1850 M Street NW, Suite 300
Washington, DC 20036

Dear Sir or Madam:

This letter documents the response of Towers Watson to the proposed actuarial standard of practice (ASOP) on Assessment and Disclosure of Risk Associated with Measuring Pension Obligations and Determining Pension Plan Contributions, as requested in the Exposure Draft (ED) of December 2014.

Towers Watson is a global human capital and financial management consulting firm specializing in employee benefits, human capital strategies, and technology solutions. Towers Watson employs approximately 15,000 associates on a worldwide basis, over 1,100 of whom are members of U.S. actuarial bodies subject to the standards and approximately 600 of whom are enrolled actuaries. The undersigned have prepared our company's response with input from others in the company.

Our comments generally support four central themes that we believe should apply to the ASOPs that can be found on our website at http://www.towerswatson.com/en/north-american-retirement-principles.

We appreciate the opportunity to comment.

Summary

We believe that pension risk is an important topic and clearly one where actuaries have substantial expertise. An ASOP that provides some guidance and a framework for performing assignments in this area can be useful. However, we do not believe that it is appropriate to require an assessment and disclosure of pension risk for substantially all pension actuarial valuations used for funding purposes. While we agree that such an approach could be a best practice for some assignments, our four broad central themes illustrate why we believe it would be inappropriate for an ASOP to require this. Specifically, we do not believe that such an assessment is necessary for "appropriate practice" for all, or even most, funding valuations, and we strongly object to the requirements the ED would impose on actuaries to do significant additional work beyond the usual scope of funding assignments.

Currently Existing Guidance

The recent revisions to ASOPs No. 4, 6, 27, 35 and 41 significantly enhanced the required ***disclosure*** of types of risks associated with pension funding, but do not require ***quantification*** of those risks. We believe that these disclosures are sufficient to satisfy any need for disclosure of risk. In our experience, these disclosures are typically accompanied by an offer (or recommendation) to perform additional work to quantify potential effects of experience differing from assumed. However, we do not believe such quantification should be required. Such additional quantification could be far more expensive than the underlying assignment, is typically not needed by plan sponsors and will therefore often be uncompensated extra work for the actuary. The ED does not even limit the required quantitative assessment to cases where the plan poses significant risks to the plan's sponsor or its participants. The ED merely limits the required quantitative disclosure to large plans (e.g., other than those disclosures required by Section 3.6) and does not list the potential risk posed by the plan as a specific factor to consider in applying judgment regarding whether the plan is to be considered large.

Nature of Funding Calculations for U.S. Qualified Pension Plans

Required funding valuations for U.S. tax qualified pension plans are exercises that produce a required contribution for a single year and a funded status. Because the assets and liabilities reflected are determined at the valuation date for the plan year, future experience different than assumed has no effect on the valuation results. In order to quantify any risk associated with such future deviations, the actuary would first need to perform future years' contribution projections assuming assumptions are realized (as acknowledged in Section 3.7, where 10-year+ projections are required) before the effect of experience different than assumed or changes in assumptions could be analyzed. Such baseline projections may well, on their own, be more expensive to perform than the required valuation to determine the current year's required contributions, and that is before the additional work to (i) determine the risks to model, the methodology to use when modeling, and the parameters and assumptions for such modeling, (ii) perform such modeling and (iii) formulate the presentation of the results to the Principal.

Breadth of Risks to be Considered

The potential risks to be modeled could be quite extensive, including asset returns, changes in interest rate environment, potentially separately for government rates and corporate rates, numbers of future new entrants, termination and retirement rates, option election experience, occurrence of layoffs, plant shutdowns or similar events, plan changes, etc., including various combinations of these events occurring at different points in the projection period. Even if an actuary devoted great effort to this exercise, there would likely be risks, or combinations of risks, that the actuary could have modeled, but did not. Requiring the actuary to identify and, in some cases, quantify all significant risks would be very expensive and not useful, and is likely to lead to significantly increased litigation against actuaries whenever anything goes wrong with a pension plan. If a standard is promulgated, the scope should be narrowed to avoid an interpretation that the required modeling could be this extensive.

Unintended Adverse Effects of Such a Requirement

Many pricings an actuary might perform would appear to be swept into these requirements since they determine the effect on contributions of contemplated plan changes or events. Applying the ED would make such pricings more expensive and time consuming and would likely result in plan sponsors requesting fewer pricings and potentially taking actions without proper analyses of their effects. Such a result would directly defeat the intended purpose of the ED.

We also note that funding valuations of qualified U.S. pension plans must be performed by Enrolled Actuaries (EAs). EAs need not be members of *any* of the five U.S. based actuarial organizations, membership in which subjects the actuary to the Code of Conduct and the ASOPs. Making funding valuations performed by credentialed members of such organizations significantly more expensive than those performed by non-member EAs may cause more funding valuations to be performed by non-member actuaries, and may provide incentive for actuaries to eschew or relinquish membership in order to avoid becoming subject to these onerous proposed standards.

Our specific feedback on the ED follows, beginning with the nine questions listed in the *Request for Comments* section of the ED.

Responses to Specific Requests for Comments

1. *The discussion draft that preceded this proposed ASOP indicated that a risk assessment should be performed for substantially all pension assignments. The exposure draft has limited the assessment to funding valuations, as defined in section 2.1. Do you believe this limitation is appropriate? Why or why not? If not, what other types of valuations should include risk assessments?*

As discussed above, and in more detail in our comments on specific sections below, we do not believe that requiring *quantitative* risk assessments for funding valuations is appropriate, and do not support extending the requirement to other pension assignments. In addition, we believe that the current standards of practice already require sufficient qualitative discussion of risk. Additional risk assessments may be "best practice" in some situations, but they are certainly not the minimum level of appropriate practice, and should not be required by a standard of practice for any assignment.

2. *Does the language in the exposure draft provide sufficient guidance to actuaries performing risk assessment work? If not, what additional guidance should be provided?*

   A standard that simply provided guidance to actuaries performing risk assessment work would be useful; this is not that standard. This standard **requires** risk assessment work, and in doing so focuses much more on what an actuary is required to do than on what the actuary should consider when doing it. In addition, the guidance that it does provide is not clear in some areas and in other areas is unnecessarily prescriptive. Some of the difficulties that are discussed in greater detail below include the meanings of "moderately adverse" and "plausible", the clarity and appropriateness of the large plan distinction, and the requirements to perform risk assessments in specific ways and at specific times (e.g., using 10-year projections, and at least every 5 years).

3. *Is the language in the exposure draft sufficiently flexible to allow for new developments in this area of actuarial practice?*

   Yes. The ED does not require specific approaches to risk assessment work; Section 3.4 provides only examples of methods that may be used.

4. *Do you agree that the guidance in section 3.3 regarding assumptions used for the assessment of risk should include moderately adverse but plausible outcomes? If no, what guidance would you propose?*

   We do not agree. We would strike the last sentence of the first paragraph. The last sentence of the second paragraph is sufficient – the assessment should reflect the actuary's professional judgment. Following is some commentary on "moderately adverse but plausible":

   The ED is not clear as to what the requirement to include moderately adverse but plausible outcomes actually means. Some dictionary definitions of "plausible" are
   - possibly true; able to be believed
   - believable or realistic
   - having an appearance of truth or reason; seemingly worthy of approval or acceptance; credible; believable
   - Seemingly reasonable or probable

   We believe there is a large gap between "possibly true, able to be believed" and "seemingly probable". In hindsight, anything that actually occurred would seem to be "possibly true, able to be believed". It is important to recognize that whether an actuary has complied with the standard will be judged after the fact, when what happened will be known, and it is likely that the assumption will be that anything that did happen had to have been plausible, whether or not it was "seemingly reasonable or probable" when the work was done. We also note that the Free Online Dictionary of Law Terms and Legal Definitions lists approximately 40 synonyms of "plausible" for legal purposes, ranging from things with small probabilities (e.g., "within the realm of possibility", "thinkable", "imaginable" and "conceivable") to much stronger likelihoods (e.g., "commanding or demanding belief" and "convincing"). It seems clear that the definition of "plausible" will be in the eye of the beholder, and too often after the fact.

5. *As discussed in section 3.5, for a funding valuation of a plan, the actuary should perform a risk assessment, which may be quantitative, qualitative, or both. Should the guidance require the actuary to use professional judgment in choosing which type of assessment (quantitative, qualitative, or both) to use? For example, if an actuary believes a quantitative assessment should be performed, do you believe providing a qualitative assessment instead of a quantitative assessment should be considered appropriate actuarial practice?*

   Yes, we do believe that providing a qualitative assessment is appropriate actuarial practice. We do not believe the mere fact that an actuary thinks something is advisable elevates it to the level of "minimum appropriate actuarial practice", such that not doing it would be inappropriate actuarial practice. We believe that the Actuarial Standards Board (ASB) is confusing the role of the actuary and the role of the plan sponsor. An actuary may believe that a plan sponsor should have many risk assessments performed, including reviews of plan documents, plan administration, asset management, the risk the plan poses to the organization due to the size of the plan relative to the size of the organization, etc. The plan sponsor may have an entirely different view of the significance of these risks than the actuary does. Risk assessments can be large, complicated and expensive projects and the actuary can and should recommend them if the actuary believes they are warranted, but the actuary cannot force the plan sponsor to engage the actuary in such efforts. We strongly believe that ASOPs cannot and should not prevent an actuary from competently performing an assignment he or she was hired to perform, and is qualified to perform, such as a funding valuation under applicable regulatory requirements, just because the plan sponsor does not view the significance of various risks in the same way the actuary does.

6. *Plan maturity measures have been included as a potential disclosure item to assist intended users in understanding the risks associated with the plan. Are there additional measures that may be disclosed that are significant to understanding the risks of the plan? If yes, what measures would you recommend as a disclosure item?*

   We do not believe that the plan maturity measures listed are necessarily relevant or appropriate in any given situation, as discussed below, and thus we also don't believe that other such measures should be identified and *required* to be disclosed that also may not be meaningful in many situations. The premise of question 6 is that this category include "potential disclosure items" yet the ED expresses much stronger language. We agree that these should be considered, at most, as potential disclosure items.

7. *Do you agree with the use of a threshold for requiring mandatory quantitative assessment that is based on the actuary's professional judgment? If not, what threshold do you believe should be used?*

   We do not believe a *mandatory* quantitative assessment is ever warranted. In addition we note that an actuary's judgment will be questioned with hindsight whenever something bad occurs and a quantitative analysis was not performed, so the actuary will be obliged to consider a quantitative analysis in most situations. And finally, we note that the ED does not leave this requirement to the actuary's professional judgment in the case of large plans.

8. *Do you believe that the term "large plan" in section 3.7 is sufficiently clear that an actuary will be able to apply it in practice? If not, what clarification would you suggest? Are there other characteristics that should be specified in determining "large plan"?*

   No, we do not believe it is sufficiently clear. A "large plan" is in the eye of the beholder, and different actuaries will come to different conclusions about what a large plan is, and it may be heavily influenced by the size of the typical plan sponsored by that actuary's particular client base. In addition, being a "large plan" is not in and of itself a risk factor. A large plan may pose little risk to its sponsor or participants (because of the sponsor's assets and financial strength relative to plan obligations, or the funded status of the plan), and a small plan may pose a significant risk to its sponsor and participants, due to its size relative to the sponsor, the financial strength of the sponsor, plan features like plant closing benefits, etc. We believe that "large plan" is both not clearly defined, and not appropriate as the basis for determining the usefulness of a quantitative assessment of risk. If the reason for the distinction is a recognition on the part of the ASB that a quantitative assessment would be very expensive, and a desire not to impose such costs on smaller plans, we respectfully submit that it is not appropriate to impose those costs on large plans either.

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9. *Is every five years an appropriate period for performing a mandatory quantitative assessment for a "large plan" in the absence of significant changes, as described in section 3.7?*

   We do not believe these assessments should be required; we certainly do not believe they should be required more frequently than every five years. There is no basis given for the period and it seems arbitrary.

Additional Specific Comments

Section 1.1 (Purpose) and Section 1.2 (Scope) – We believe these sections are inconsistent in the way they describe the scope of the standard. Section 1.1 suggests that it applies "with respect to measuring obligations under a pension plan", which would appear to include accounting valuations and other activitities unrelated or only tangentially related to determining funding requirements (e.g., regulatory funded status certifications). However, Section 1.2 suggests it is limited to funding valuations. In addition, the specific references in Sections 3.5- 3.7 to "a funding valuation of a plan" call into question whether or not the entire ED is limited to funding valuations; if it is there would not seem to be a need to specifically refer to funding valuations in these sections. We believe the intended scope should be clarified and limited (if the standard is in fact promulgated, which we don't recommend).

Section 1.4 (Effective Date) - The effective date of four months after adoption is not sufficient for major changes in the required work for a funding valuation. The additional costs will need to be included in scopes of work that are typically signed before the beginning of the year in which the valuation date falls. In addition, we note that it is not clear when a quantitative risk assessment would be required for a large plan that had not had one performed in the past. Immediately, since one was not done within the preceding 5 years? Within the 5-year period beginning on the effective date?

***Section 2.1 (Definition of Funding Valuatio*n)** – The definition is not clear as to whether pricing work (e.g., determining the effects on funding of proposed plan changes) is included; as discussed above, we believe including such work in the definition would be counterproductive, and request clarification that it is not included.

Section 3.1 (Overview) – This section indicates that more guidance is needed because "a user of the measurement may not understand the effects of future experience differing from the assumptions used". The current ASOPs that apply to pension measurements already require disclosure of the fact that assumptions may not be realized, and that future results will differ as a result. In particular, ASOP 4 section 4.1r requires:

> *"r. a statement, appropriate for the intended users, indicating that future measurements (for example, of pension obligations,* ***periodic costs****,* ***actuarially determined contributions****, or* ***funded status*** *as applicable) may differ significantly from the current measurement. For example, a statement such as the following could be applicable: "Future actuarial measurements may differ significantly from the current measurements presented in this report due to such factors as the following: plan experience differing from that anticipated by the economic or demographic assumptions; changes in economic or demographic assumptions; increases or decreases expected as part of the natural operation of the*

methodology used for these measurements (such as the end of an amortization period or additional cost or contribution requirements based on the plan's funded status); and changes in plan provisions or applicable law.

In our experience this disclosure is typically accompanied by an offer to illustrate ranges of results if desired by the Principal.

We believe that such currently required disclosure, along with other requirements in ASOPs 27 & 35 (ASOP 27 section 3.5.5 and ASOP 35 Section 3.10.5) to disclose the effects of changes in circumstances on assumptions, and the requirement in ASOP 41 Section 4.1.3.d to disclose "any cautions about risk and uncertainty" already provide sufficient notice to users of the effects of future experience differing from the assumptions used and changes in circumstances. Mandating additional information (either qualitiative or quantative) be provided that the intended user has already been made aware may be of interest, but that the intended user has not requested, is inappropriate in a standard. We also note that this section refers to a "user" rather than an "intended user". Users could include a whole host of parties other than the plan sponsor and we believe this should be narrowed to "intended user".

Section 3.2 (Risks to be Assessed) – We believe that the reference to the actuary not being required to evaluate "the ability of the plan sponsor or other contributing entity to make contributions" should be changed to "the ability *or willingness* of the plan sponsor or other contributing entity to make contributions", or, perhaps more to the point, to "the likelihood that contributions will be made".

Section 3.3 (Assumptions for Assessment of Risk) – This section requires that assumptions used for the assessment of risk "should reflect moderately adverse but plausible outcomes". The reference to "adverse" does not appear in the definition of **risk** or in Section 3.2 (*Risks to be Assessed*). If the risk to be considered is limited to bad outcomes, that needs to be made clearer before Section 3.3. In addition, as discussed above, the requirement to reflect "plausible but moderately adverse" outcomes is problematic in that 'plausible" is not well defined. We also are concerned about limiting the scenarios to moderately adverse outcomes as significantly adverse (but still plausible) outcomes would seem to present greater risk. The subjectivity of this issue illustrates the need for judgment and supports our strong concern regarding requirements throughout the ED.

Section 3.5 (Assessment of Risk) – We adress the potential requirement for a quantitative analysis in our comments on Section 3.7 below. With respect to a qualitative assessment, we believe that any such requirement would be largely redundant given the currently required disclosures as discussed in our comments on Section 3.1 above, and that any additional disclosure would simply add additional more specific, but still boilerplate, language to reports, providing obvious statements such as "the funded status will worsen if people live longer than has been assumed in the funding valuation", rather than the current disclosure cited above that a whole host of assumptions may not be realized and may cause results in the future to diifer.

Section 3.6 (Plan Maturity Measures) – Section 3.6 indicates that the actuary is to disclose such plan maturity measures only if the actuary believes they are significant, and in many cases given the facts and circumstances the actuary is likely to conclude that they are not. However, we remain concerned that the connection between the "plan maturity measure" examples and "the **risks** associated with the plan" is unclear given the definition of **risk**, and that, as a result, what is required to be disclosed may be interpreted differently by different parties. This may lead actuaries to feel compelled to disclose items even though they do not believe them to be significant. As noted above, we suggest reconsidering this area.

Specifically, risk appears narrowly defined in Section 2.2 as the potential that assumptions will not be realized. But the examples listed in Section 3.6 seem more related to risks that are external to the valuation of the plan's liabilities, and that would constitute risks even if all assumptions were precisely realized.

For example, the maturity measure in a. (relationship of market value of assets to payroll) is not related to a plan **risk** as **risk** is defined – it is more a risk related to the sponsor's economic activity and ability to fund the plan, a risk specifically excluded from consideration in Section 3.2. This comment assumes that payroll is intended to mean total payroll, not payroll covered by the plan. If the latter definition is intended then we believe the measure has little or no relevance.. Similarly, maturity measure b (ratio of retired liability to active liability) is not related to a plan **risk** as risk is defined. If the plan is closed or does not cover the employer's entire workforce, the relationship of active to inactive liability is irrelevant. If the plan does cover the employer's entire workforce, then the risk of a high ratio is similar to the risk for measure a as it relates to the employer's ability to support the plan rather than a plan risk.

Maturity measures c. and d. only seem relevant if there is a projected inability to pay benefits when due; if the actuary only needs to disclose it in such a case it should say so explicitly. However, we note that the actuary would not be required to disclose if the projected inability to pay benefits when due would be caused by the plan sponsor's projected inability or unwillingness to fund, and ASOP 4 section 3.14.1 already requires disclosure otherwise when it provides that "if, in the actuary's professional judgment, such a contribution allocation procedure is significantly inconsistent with the plan accumulating adequate assets to make benefit payments when due, assuming that all actuarial assumptions will be realized and that the plan sponsor or other contributing entity will make actuarially determined contributions when due, the actuary should disclose this in accordance with section 4.1(l)."

We also request clarification that net cash flow refers to contributions less benefit payments for the plan as opposed to net cash flow for the plan sponsor or its controlled group.

Section 3.7 (Quantatitive Assessment of Risk for Large Plans) – We believe that the concept of requiring additional quantitative analysis for a "large plan" is neither clear nor appropriate. This section does not address the fact that "large" is in the eye of the beholder, and any heightened risks associated with being large typically come about only if the plan is large relative to the size of the entity sponsoring it. A small plan may pose far more risk to a small employer than a much larger plan poses to a large employer. If such additional quantitative analysis were required, it should be required based on the degree of risk the plan poses to the entity (and thereby, by extension, to participants), not on the size of the plan. The specific examples shown (items a. to c.) of factors for the actuary to consider do not relate in any way to actual risk; they relate only to size. This section is perhaps implicitly acknowledging the significant costs likely to result from this requirement and a judgement that these costs should only be imposed on sponsors of large plans (or more appropriately on their actuaries, as it is likely to be difficult for actuaries to be compensated for this additional work required by the standards of practice that the Principal otherwise would not find value in), but, if that is the case, we believe that imposing the costs based on perceived ability to pay is misguided and inapproriate.

This section is requiring a very significant actuarial exercise to be performed at least once every 5 years, or more frequently if the actuary judges that significant changes have occurred such that an update is required. Given the litigious climate, actuaries may feel compelled to perform these reviews more frequently to guard against a determination, should the plan sponsor or the actuary be sued for any reason, that the standard was not followed. The standard requires at least 10-year projections of obligations and costs (an exercise that may not be needed or desired for any other purpose) to be used as a baseline, along with a potentially large number of scenarios to be modeled based on combinations of various deviations from experience. We strongly believe that to dictate that "appropriate practice" must include this exercise is not warranted, and that to require it for some plans but not others based on size, without regard for the risk posed to the plan sponsor or the participants of deviations from expectations, is inappropriate.

We strongly recommend that the ASB reconsider the entire premise of an additional standard here in favor of relevant guidance to actuaries performing risk assements that we mention above. At a minimum, the scope needs to be significantly narrowed, professional judgment needs to be substituted for the proposed specific requirements and the existing guidance should be recognized as more than sufficient in many cases, particularly for situations that are already heavily regulated.

Thank you for this opportunity to comment on the Exposure Draft. If you have any questions concerning our comments, please contact either of us directly.

Sincerely,

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