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October 19, 2016

Request for Comments – Risk ASOP

Actuarial Standards Board
1850 M Street, NW, Suite 300
Washington, DC 20036

To: Actuarial Standards Board (ASB), Request for Comments – Second Exposure Draft – Assessment and Disclosure of Risk Associated with Measuring Pension Obligations and Determining Pension Plan Contributions

These comments are offered in response to the request for written comments on the second exposure draft for a new ASOP on the topic of pension risks. They were developed through the coordinated efforts of members of the Conference of Consulting Actuaries' (CCA) Public Plans Community and are being submitted to the ASB by the Steering Committee of the CCA Public Plans Community. However, these comments do not necessarily reflect the views of the CCA Board, the CCA's other members, or any employers of CCA members, and have not been endorsed by any of the aforementioned parties.

The CCA Public Plans Community (PPC) represents a broad cross-section of public-sector actuaries whose extensive experience with public plans provides the framework for our response. The PPC includes over 50 leading actuaries whose firms are responsible for the actuarial services provided to the majority of public-sector retirement systems in the United States. Our membership reflects a diversity of opinions and perspectives on public pension plan valuation issues, so not all of our community, necessarily, subscribe fully to all of the comments presented here. Nonetheless we believe the overall response reflects a substantial consensus among the actuaries who provide valuation and consulting services to public pension plans in the United States.

We are grateful to the ASB for formulating ASOPs on the assessment and measurement of risks and inviting public-sector actuaries and others to comment on these important issues. We are also grateful to the ASB and their Pension Committee for their hard work in striving to understand these issues.

Paul Angelo, FSA, FCA, MAAA, EA (By Direction)
Chair of the Public Plans Steering Committee
on behalf of the Public Plans Steering Committee

Public Plans Community Steering Committee

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Steering Committee of the Conference of Consulting Actuaries' Public Plans Community¹

Response to the Actuarial Standards Board (ASB)

Request for Comments – Assessment and Disclosure of Risk Associated with Measuring Pension Obligations and Determining Pension Plan Contributions

We are pleased to submit the following comments to the Actuarial Standards Board (ASB) regarding the second exposure draft of the proposed Actuarial Standard of Practice (ASOP), *Assessment and Disclosure of Risk Associated with Measuring Pension Obligations and Determining Pension Plan Contributions*. We begin by noting that overall we find this second exposure draft to be a significant improvement on the December 2014 draft, both in the content and the clarity of the guidance. In particular, we believe the move away from the requirement of qualitative assessments for large plans is an appropriate direction for this ASOP. However, we believe there remain areas for improvement to this ASOP prior to its adoption. Our comments discuss individual sections of the proposed ASOP, following the order of the sections. In addition to discussion, we recommend specific changes to the language of the ASOP in a number of sections. Where we have done so, we highlight the text where we have added or deleted words in yellow, striking through those words we recommend removing. Finally, the three specific questions asked in the second exposure draft are addressed in the relevant sections: Section 2.3 for question 1, Section 3.6 for question 2, and Section 3.8 for question 3.

We have only one comment on Section 1, a general comment relating to the scope of the proposed ASOP. We note that OPEB plans are excluded from the scope of the proposed ASOP as written, and encourage the ASB to consider developing a similar standard for OPEB plans following the completion of this project. This additional ASOP would be titled *Assessment and Disclosure of Risk Associated with Measuring Retiree Group Benefit Obligations and Determining Retiree Group Benefits Program Contributions* if a naming convention similar to that of ASOP Nos. 4 and 6 is followed.

We have comments on four definitions within Section 2, beginning with Section 2.1. We believe this definition should reflect the valuation practices of all plans, particularly fixed contribution rate public and multiemployer plans, many of which commonly evaluate implicit funding periods in assessing funding. In addition, we believe the application of this standard to ERISA funding valuations should be clarified. Accordingly, we recommend the following edits to Section 2.1:

2.1 Funding Valuation—A periodic measurement of pension obligations performed by the actuary that the plan sponsor may use to determine plan contributions or the benefit levels and/or funding periods supportable by specified contribution levels. ~~A funding valuation includes the~~ The determination of the minimum required contribution, as defined by the Employee Retirement Income Security Act of 1974 (ERISA) is considered a funding valuation for the purposes of this standard.

The second definition on which we have a comment is Section 2.2. We feel that this definition needs to make clearer whether periodic cost includes accounting or just refers to funding. It is our recommendation that this definition should make clear that periodic cost in this ASOP refers only to measurements made for funding purposes. Accordingly, we recommend the following edit to Section 2.2:

2.2 Pricing Valuation--A measurement of pension obligations performed by the actuary for funding purposes to estimate the impact on the periodic cost or the actuarially determined contribution of proposed changes to plan benefit provisions.

¹ These comments were developed through the coordinated efforts of the Conference of Consulting Actuaries' (CCA) Public Plans Steering Committee and are being submitted to the ASB by the Steering Committee of the CCA Public Plans Community. However, these comments do not necessarily reflect the views of the CCA Board, the CCA's other members, or any employers of CCA members, and should not be construed as being endorsed by any of the aforementioned parties.

The third definition from Section 2 on which we have comments relates to the first specific question in the second exposure draft, which asks if we believe that the addition of contribution risk in Section 3.3 is consistent with the risk definition in 2.3. While we generally believe that it is consistent, we also believe that contribution risk, as described in item 3.3.e, should be explicitly defined in section 2. We anticipate this definition would likely be added after the current Section 2.3 defining Risk and before the current Section 2.4 defining Scenario Test. We recommend that the text from item 3.3.e be used so that this definition could read as follows:

2.4 Contribution Risk—The potential that the plan’s funding policy is not consistent with an actuarially determined contribution, that actual contributions are not made in accordance with the plan’s funding policy, or that material changes occur in the anticipated number of covered employees, covered payroll, or other relevant contribution base.

With this change, item 3.3.e could then be edited as follows, leaving only the (bold) defined term **contribution risk**:

3.3.e. **contribution risk** (i.e., ~~The potential that the plan’s funding policy is not consistent with an actuarially determined contribution, that actual contributions are not made in accordance with the plan’s funding policy, or that material changes occur in the anticipated number of covered employees, covered payroll, or other relevant contribution base.~~) [bold on “contribution risk” added by the edit]

The final item in Section 2 on which we have comments is Section 2.7, Stress Test. The first edit we suggest is to replace “measuring” with “assessing” to be more consistent with the previous definitions in current Sections 2.4 and 2.5, and to better convey the possible use of this method when a true “measurement” may not be possible or cost-effective, but some type of an assessment can nonetheless be completed. We also recommend replacing “adverse” with “significant” to acknowledge that risk can be experienced in two directions, both favorable and unfavorable. Accordingly, we recommend the following edits to Section 2.7:

2.7 Stress Test--A process for ~~measuring~~ **assessing** the impact of ~~adverse~~ **significant** changes in one or relatively few factors affecting a plan’s financial condition.

Our primary recommendation relating to Section 3 is that the order of Sections 3.2 and 3.3 be reversed. We believe that this will improve the flow and usability of the ASOP as it will address identifying risks first and then address assessing those identified risks. The current order addresses assessment of the risks prior to their identification.

Regarding Section 3.3 and the addition of contribution risk, our primary comment was discussed previously, that we feel contribution risk should be explicitly defined in Section 2.

Additionally, we recommend that item 3.3.d be changed to acknowledge that there are demographic risks other than longevity that can materially affect future outcomes. For example, actual retirement rates varying from what is assumed can have a material impact on the value of a retirement benefit change. Therefore, we recommend this section be edited to expand the focus to general demographic risks as follows:

3.3.d. longevity **and other demographic risks** (i.e., the potential that mortality **or other demographic** experience will be different than expected); and

Regarding Section 3.6, the second specific question in the second exposure draft asks if we agree with the proposed guidance in section 3.6 stating that an actuary should recommend to their intended user that a more detailed assessment of the risks identified by the actuary be performed if the actuary feels in his or her professional judgment that this more detailed assessment would be beneficial for the intended user in

understanding the identified risks. We do agree with this guidance, but recommend two revisions that would improve this section and its appropriate role in influencing practice.

We believe that, considering the meaning of “should” in ASOP 1, the guidance “should recommend ... that such an assessment be performed” is too strong in the second exposure draft. We recommend modifying Section 3.6 to say that the actuary “should recommend” that the intended user “consider” having this assessment performed. This change would permit the intended users, in consultation with the actuary, to adopt the risk analysis most appropriate to their situation, recognizing that some intended users may be essentially required by their own practices to adopt the actuary’s recommendations. Additionally, we recommend replacing the word “beneficial” with “necessary.” Beneficial implies any positive outcome of additional analysis justifies its recommendation, regardless of the magnitude of the benefit and/or the necessary cost for its completion. “Necessary” instead allows evaluation of the magnitude of the benefits derived from the additional analysis as well as consideration of cost. To implement these two changes, we recommend that this section be revised as follows:

3.6 Additional Assessment of Risk--If, in the actuary's professional judgment, a more detailed assessment would be beneficial necessary for the intended user to understand the risks identified by the actuary, the actuary should recommend to the intended user that such an assessment be performed considered.

Also in Section 3.6, we recommend a revision to the example of factors to consider listed in Section 3.6.f. We believe the current reference to contribution allocation procedure should be expanded so as to be applicable to all plans, including those whose contributions are set as a fixed rate. We therefore recommend a change to this item as follows:

3.6.f. any relevant characteristics of the contribution allocation procedure or any other method for determining actual contributions, such as a significantly backloaded contribution allocation procedure;

The third specific question in the second exposure draft asks if we believe the guidance in the new Section 3.8 regarding disclosure of historical actuarial measurements and potential disclosures of other historical information relevant to actuarial measurements to assist in understanding the risk associated with plans is appropriate. Generally, we do think that this is appropriate. Further, we like the proposed language but recommend that historical measures of plan maturity be added to the list of examples in Section 3.8. This can be done by adding within Section 3.8 a new example:

e: plan maturity measures.

In Section 4, we believe that the order of the current Sections 4.1.a and 4.1.b should be reversed so that the identification of the risks to be assessed precedes the assessment of these risks, consistent with our comments on Sections 3.2 and 3.3 above.

Additionally, in the current 4.1.b, we believe that the rationale for selecting the risks to be assessed is a necessary part of the risk assessment rather than a separate disclosure. Otherwise, the rationale for every risk assessed may end up as essentially a recitation of the text from the current Section 3.3; i.e., that the risk “may reasonably be anticipated to significantly affect the plan’s future financial condition.” Further, we recommend that the explanation of the “significance” of the risk be incorporated in the assessment that is performed after the relevant risks are identified.

Accordingly, we recommend the following revisions to 4.1.b (which above we recommend become Section 4.1.a):

4.1.b.a. the risks identified, in accordance with section 3.3, including the rationale for selecting the risk and the actuary's view of the significance of each identified risk;

We also recommend the following revisions to the current Section 4.1.a (which above we recommend become Section 4.1.b), consistent with our recommended changes to the current Section 4.1.b:

4.1.a.b. the results of the risk assessment performed in accordance with section 3.2, including commentary about the rationale for each identified risk, the actuary's view of the significance of each identified risk, and the actuary's view on the specific circumstances applicable to the plan taken into account;

Our final comments are on Section 4.2. We note that Sections 4.2.a and 4.2.b of the second exposure draft follow the structure and requirements of ASOP No. 41 Sections 4.2 and 4.3 respectively in referring to assumptions and methods as “prescribed by applicable law [including] legally binding authority” and “selected [or set] by another party.” However, the current ASOP No. 4, which was revised three years after the current ASOP No. 41, makes an important clarification regarding assumptions or methods that are set by a legally binding authority that sponsors the plan. In this circumstance, in effect the more stringent disclosure requirements of Section 4.3 of ASOP No. 41 apply, rather than those of Section 4.2 of ASOP No. 41. We believe that, ultimately, ASOP 41 should be amended to incorporate these concepts, including the definitions from ASOP No. 4 Sections 2.20 and 2.21. In the interim, we recommend that this clarification from ASOP No. 4 be incorporated in the risk ASOP, including the appropriate definitions as required.