Segal Consulting

MEMORANDUM

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

From: Thomas D. Levy, FSA, FCA, FCIA, MAAA, AIA, EA
Senior Vice President and Chief Actuary

Date: October 31, 2016

Re: Proposed ASOP, Assessment and Disclosure of Risk Associated with Measuring Pension Obligations and Determining Pension Plan Contributions

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The Segal Group (Segal) is pleased to comment on the above proposed Actuarial Standard of Practice (ASOP). Segal is a major consulting firm active in all markets, with special expertise in the multiemployer and public sector areas. We agree including an assessment and disclosure of risks as a component of funding and pricing valuations would assist intended users in their understanding of the actuarial communications.

Our comments include responses to the questions asked in the cover memo as well as comments on specific sections of the exposure draft.

Responses to Questions

Our responses to the questions asked by the ASB are shown below:

- **1. Do you believe that the addition of contribution risk in section 3.3 is consistent with the risk definition in section 2.3?**

  We believe that the linkage between the definition of risk in section 2.3 and the addition of contribution risk in section 3.3 is inconsistent as written. In general, actuaries do not think of the failure to contribute the actuarially determined contribution as “actual future experience deviating from actuarially assumed experience.” One possibility would be to expand the section 2.3 risk definition based on the language in Section 3.3(e): “For purposes of this standard, risk includes contribution risk,” and then separately define contribution risk as “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," using the language that is currently in section 3.3(e).

- **2. Do you agree with the proposed guidance in section 3.6 that if, in the actuary's professional judgment, a more detailed assessment would be beneficial 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?**

  We believe that risk disclosure is essential and at a minimum should be discussed. We recommend that the language be revised to say, "If, in the actuary's professional judgment, a more detailed assessment would be significantly beneficial 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 considered."

- **3. Do you believe that the guidance in section 3.8 regarding the disclosure of historical actuarial measurements or potential disclosure of other historical information to assist in understanding the risks associated with the plan is appropriate? If not, what changes would you suggest?**

  We agree that the disclosure of historical actuarial measurements to assist in understanding the risks associated with the plan is appropriate. The disclosure of other historical information relevant to the actuarial measurements should be limited to quantitative and not behavioral information and should be related to the plan itself. It should be clear that historical maturity measurements are included, whether in Section 3.7 or in Section 3.8.

Comments on Specific Sections of the Exposure Draft

Our detailed concerns with respect to the exposure draft include the following:

- Section 1: We believe that the purpose and scope of this standard should be clarified. A distinction that may be useful is between services the actuary provides to a principal or for an intended user such as a valuation report or projections, which we believe should be subject to this standard, and services such as the preparation of a government filing, which we believe should not be subject to this standard. For this purpose, we would apply the concept of "set by law" as it is used in ASOP No. 4 and not the broader concept of "applicable law" used in ASOP No. 41.

- Section 1.2: The third paragraph provides that "this standard does not require the actuary to evaluate the ability of the plan sponsor…to make contributions…." We recommend that this paragraph be expanded by adding the phrase "or willingness." The paragraph would then say that "this standard does not require the actuary to evaluate the ability or willingness of the plan sponsor…to make contributions...."

- Section 2: Although Section 1.1 makes it clear that "plan" and "pension plan" refer to a defined benefit pension plan, there are other terms used in the standard such as "actuarially determined contribution" that have specific definitions in other ASOPs. We recommend that these terms also be defined in this standard so as to reduce the need to crosscheck against other ASOPs.

- Section 2.1: The last sentence refers to ERISA. If that sentence is intended to be clarifying about what a funding valuation is, it should be expanded to include contributions determined for public sector plans. In addition, some plans have fixed contribution rates. For these plans, there may not be an actuarially determined contribution. Rather, the valuation solves for the effective amortization period based upon those contribution rates. These valuations should be included in the definition of a funding/pricing valuation. Finally, it is unclear whether this definition includes solvency cash flow projections. We recommend that it be clarified whether or not this standard applies to solvency cash flow projections and, if so, that a separate definition for solvency cash flow projections be used in the standard.

- Section 2.2: As this proposed standard focuses on contribution requirements and the associated risks for the funding and pricing of pension plans, we recommend that the reference to "periodic cost" be deleted. "Periodic cost" is defined in ASOP No. 4 as "the amount assigned to a period…for purposes other than funding…. In many situations, periodic cost is determined for accounting purposes." Use of the term "periodic cost" may be interpreted as requiring that this standard apply to accounting valuations or pricing valuations that are focused on accounting results.

- Section 2.3: As mentioned above in our response to Question 1, we believe that the definition of risk should be expanded to explicitly include the different situations listed in Section 3.3(e) on contribution risk. Given the number of situations covered by the phrase "contribution risk," we recommend including that as its own term and then stating that risk also includes contribution risk. We also believe that the issue of whether model risk is included in the definition of risk for purposes of this standard should be clarified, given the existence of the exposure draft on modeling. There is a possibility that the two standards could be conflicting.

- Section 2.7: We recommend changing "measuring" to "assessing" to be consistent with the prior subsections. We note that this is the only one of the tests described in the standard that focuses on "adverse" changes instead of deviations both positive and negative.

- Section 3.3: We note that the list of examples includes three economic risks, one contribution risk, and one demographic risk. We recommend adding another demographic risk example to provide more balance in the list of examples. One possibility would be: "retirement risk (i.e., the potential that retirement experience will be different than expected)." In addition, there is also the risk of multiple individual risks combining together to produce an extreme result as well as the possibility of leveraging – a small change in an asset or liability measurement could have a large impact on contribution requirements or other measurements.

- Section 3.3(e): Although this covers "contribution risk," it is immediately followed by the statement, "This standard does not require the actuary to evaluate the ability of the plan sponsor or other contributing entity to make contributions to the plan when due." This statement is also included in Section 1.2. In both sections we recommend that the language say "the ability or the willingness." Sections 3.4 and 3.5: We recommend that the order of these sections be reversed as it makes more sense to discuss methods for assessment of risk before discussing assumptions for assessment of risk.

- Section 3.6: As noted in our response to question 2, we recommend that the language be revised to say, “If, in the actuary’s professional judgment, a more detailed assessment would be significantly beneficial 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 considered.”

- Section 3.8: We recommend that the list of examples of historical information include historical plan maturity measures as that would be consistent with the snapshot calculations in Section 3.7 and would show the historical pattern of the plan’s maturity. We recognize that these are intended to be examples but believe that a plan’s maturity is often a major factor contributing to its risk levels and that including references to maturity in both Sections 3.6 and 3.7 but not in Section 3.8 might lead an actuary to think that the Section 3.8 was not intended to cover historical maturity measures.

- Section 3.9: Is this section intended to say that an actuary can be silent on a relevant risk because there is a separate report produced by someone else covering that risk? Or is it that the actuary can reference that separate report, indicate that the actuary has relied on it and therefore not have to provide additional analysis? We recommend that the guidance be the latter and that a corresponding disclosure requirement be added to section 4.

- Section 4.1: In light of the facts that actual experience is almost never the same as assumed and that hindsight is 20-20, we recommend adding a disclosure requirement such as the following, modified as appropriate:

> The actuary does not know in advance the actual future of the pension plan, in particular which assumptions will have the largest variation from actual experience, and therefore which experience will have the largest effect on future actuarial measurements. It is possible that experience with a high variation from the assumption but with a low probability of occurrence will actually result for some assumptions. Therefore, the descriptions of risks faced by the pension plan are not intended to be exhaustive or precise. Instead, they were chosen to convey to the intended user the fact that variations in actual experience versus assumptions or changes in actuarial assumptions can result in significant variation in future actuarial measurements, and do not indicate that the actuary’s prior judgments were erroneous.

- Section 4.2(a): We believe that this requirement should be similar to the disclosure in ASOP No. 4 that makes a distinction between a “prescribed assumption or method set by law” and a prescribed assumption set by another party,” where the latter includes “an assumption or method set by a governmental entity for a plan that such governmental entity or a political subdivision of that entity directly or indirectly sponsors.” If the requirement is changed along these lines, then these definitions should be added to Section 2.

Please contact us if you wish to discuss any of these views further.

TDL/jpb