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October 31, 2016

Request for Comments – Pension Risk ASOP (Second Exposure)
Actuarial Standards Board
1850 M Street NW, Suite 300
Washington, DC 20036

**Re: Second Exposure Draft:** ***Assessment and Disclosure of Risk Associated with Measuring Pension Obligations and Determining Pension Plan Contributions***

Members of the Actuarial Standards Board:

The Pension Committee, Multiemployer Plans Subcommittee and the Public Plans Subcommittee of the American Academy of Actuaries[1] are pleased to present the following comments to the Actuarial Standards Board (ASB) regarding the second exposure draft of the proposed actuarial standard of practice (ASOP) on risk assessment and disclosure. Although we believe there have been improvements compared to the initial draft of the proposed ASOP, we still have concerns about the second exposure draft.

**Answers to ASB's Questions**

As you requested, following are our responses to the questions posed in the request for comments:

1. *Do you believe that the addition of contribution risk in section 3.3 is consistent with the risk definition in section 2.3? If not, how would you modify the definition in section 2.3?*

   We believe that the definition of risk in section 2.3 should be expanded to explicitly cover contribution risk, because the current section 2.3 definition seems to cover only actual experience differing from expected based upon the actuarial assumptions. While actuarially determined contributions are based on assumptions, certain contribution risks described in section 3.3 are not based upon actuarial assumptions.

   To accomplish this, we suggest that the term "contribution risk" should be separately defined in section 2 using the text in section 3.3(e) and the language should be expanded to include unpaid withdraw liability:

[1] The American Academy of Actuaries is an 18,500+ member professional association whose mission is to serve the public and the U.S. actuarial profession. For more than 50 years, the Academy has assisted public policymakers on all levels by providing leadership, objective expertise, and actuarial advice on risk and financial security issues. The Academy also sets qualification, practice, and professionalism standards for actuaries in the United States.

"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, that material changes occur in the anticipated number of covered employees, covered payroll, or other relevant contribution base, or that withdrawing employers might not pay the full share of its unfunded vested benefits allocation in withdrawal liability payments."

Section 3.3(e) could then be shortened by reference to the new term defined in section 2.

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?*

   Overall, we agree. It is important, however, that the requirement to recommend consideration of a more detailed assessment be limited to the actuary's judgment of what the intended user would find "substantially beneficial" as we think the term "beneficial" by itself creates too low of a threshold. Letting the intended user decide whether it is worth incurring the added cost for additional work is also important and making recommendations to take certain actions may bind intended users in ways they find are not appropriate. As a result, suggesting they consider having an assessment performed, rather than providing a recommendation that an assessment be performed, provides flexibility to the intended users.

   Specifically, we suggest that:
   - the words "recommend to the intended user that such an assessment be performed" be changed to "recommend that the intended user consider whether such an assessment should be performed", and
   - the words "a more detailed assessment would be beneficial for the intended user" be changed to "a more detailed assessment would be of substantial benefit to the intended user."

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?*

   Overall we believe that it is appropriate but that more needs to be added. In particular, it would be helpful if the maturity measures in section 3.7 were also provided on a historical basis by amending section 3.8 to include maturity measures among its examples.

**Specific Comments**

In addition, we have specific comments on various sections of the proposed ASOP:
- Section 1: In some situations, the funding standards that apply to a plan are not determined in a single annual actuarial valuation, but rather consist of multiple calculations and certifications that occur during a year. This is the case with multiemployer plans that are

subject to ERISA, where zone status certifications, rehabilitation plan updates, and scheduled progress evaluations can affect the funding standards, but is also true for single employer plans (e.g., AFTAP certifications, 4010 exemption test measures, and PBGC variable premium determinations can potentially affect the amount of employer funding contributions). In order to resolve any ambiguity regarding the required risk assessments and prevent unnecessary repetition of disclosures and analyses, we suggest that Section 1 contain the following:

> "If the funding standards applicable to a plan incorporate multiple calculations and certifications that are prepared at different times during the year, then the actuary may perform a single risk assessment that is part of the primary annual actuarial report that considers these calculations and certifications, or may prepare separate assessments in conjunction with each calculation and certification."

- Section 1.2: We suggest expanding the second paragraph of this section to clarify that withdrawal liability valuations are outside of the scope of the standard. The withdrawal liability payments that an employer makes after ceasing participation in a plan may be classified as plan contributions. It is therefore possible to conclude that withdrawal liability valuations are funding valuations for the purposes of this exposure draft, though we do not believe that is the intent. An explicit statement in section 1.2 that excludes withdrawal liability valuations from the scope of the standard will remove any ambiguity on this issue.

  We also suggest that section 1.2 contain a statement confirming that the standard does not apply when results are provided to a regulatory agency. For example, when an actuary communicates the results of an annual ERISA funding valuation to a plan sponsor, the standard would apply to that communication. When the actuary subsequently prepares the actuarial information for the annual Form 5500, the exposure draft could be interpreted as requiring that the results of a risk assessment be included with this preparation. Section 1.2 should make it clear that a risk assessment is not required when an actuary communicates results that are solely intended to satisfy a government filing requirement.

- Section 2: At various points in the draft, terms are used that are not defined within the standard (for example, "actuarially determined contribution" in section 1.1 and "market-consistent present value" in section 3.5 are defined in ASOP No. 4 but not here). We have some concern about cross-referencing definitions from one standard to another, as amended or restated versions of those ASOPs could make changes that inadvertently modify the guidance in this standard. We would recommend the ASB consider defining all pertinent terms within this standard in section 2 or at a minimum making a reference to where these terms are defined. It would not be necessary to include those defined in ASOP No. 1 as those definitions apply to all standards.

  As we note in our comments on section 4.2 below, the definitions may need to incorporate two definitions used in ASOP No. 4 ("Prescribed Assumption or Method Set by Law" and "Prescribed Assumption or Method Set by Another Party.") ASOP Nos. 4, 27, and 35 revise the standard language incorporating ASOP No. 41 in the disclosure section 4.2(a) to state that "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 is not a prescribed assumption or method set by law."

- Section 2.1: The definition should make it clear that this includes a report that is a periodic review of a fixed-rate contribution level (e.g., where the contribution is fixed by law and the effective the amortization period is calculated).

  In some cases, plan sponsors may determine contribution levels based on cash flow projections, as opposed to liability measurements. As written, it is not clear that a cash flow projection may be included in this definition. We suggest clarifying the treatment of cash flow projections in the first sentence of this definition as follows: "A periodic measurement of pension obligations or projection of cash flows performed by the actuary..."

  The final sentence of section 2.1 could be read as defining a funding valuation under this ASOP as only being an ERISA funding valuation. It would be clearer if this sentence read "For purposes of this ASOP, a determination of the minimum required contribution, as defined by the Employee Retirement Income Security Act of 1974 (ERISA), is one example of a funding valuation."

- Section 2.2: Reference to periodic cost should be changed to periodic funding cost, as this standard generally refers to funding concerns. If it is intended to refer to measurements of accounting costs, we recommend that the intention for this standard to apply to accounting cost be made clearer.

  Similar to our comments on section 2.1, section 2.2 should include a clarification that cash flow projections may be considered a pricing valuation.

- Section 2.3: The definition of risk should be expanded to explicitly cover contribution risk as that does not meet the current definition. The expansion of the definition could incorporate the concepts in the parenthetical phrase in section 3.3(e). Please see our response to Question 1 for suggested language.

- Section 2.6: We suggest replacing "estimating distributions of potential outcomes" with "assessing the range and probabilities of potential outcomes" in order to make the definitions in sections 2.4 through 2.7 more parallel.

- Section 2.7: We suggest replacing "measuring" with "assessing" in order to make the definitions in sections 2.4 through 2.7 more parallel.

- Section 3.2: First, we suggest that the order of Section 3.2 and Section 3.3 be reversed, so the reader identifies the risks before being instructed to assess them. We also suggest that the first sentence be revised to begin "The actuary should assess each of the risks..." Otherwise, the language sounds as if it is a disclosure requirement, which would be more appropriate in section 4.

- Section 3.3: For clarification, we suggest that the last sentence in the first paragraph of section 3.3 be modified to read "Such risks may include, but are not limited to, the following:" We understand that the list is not intended to be exhaustive, but believe this change would be useful to emphasize that point. Also, longevity risk is the only demographic risk mentioned. We suggest adding as an example demographic risk, which includes variations in other significant assumptions, such as retirement risk.

If contribution risk is separately defined in section 2 as we suggest in our response to Question 1, then the parenthetical description in section 3.3(e) will be redundant and should be deleted.

- We suggest that the order of sections 3.4 and 3.5 be reversed. This would enhance the implied flow of operations, because typically methods are selected before assumptions within those methods are chosen.

- Sections 3.3, 3.6, 3.7, and 4.1(e) all include lists of examples that we find informative. We understand some may interpret each example to be a required item (which they are not) and some will consider them as exhaustive lists (which they are not). We believe that it is appropriate and helpful to leave these lists in the proposed ASOP.

- Section 3.7: In section 3.7(c), we believe it would be helpful to avoid any confusion to change the term "net cash flow" to "net cash flow (contributions less benefit payments)" to be clear the example refers to net non-investment related cash flow, either with or without administrative expenses.

  Section 3.7(d) lists as one of the maturity measures "the ratio of benefit payments to contributions." We are not sure that this is a broadly appropriate measure of plan maturity, although it may be for certain plans. A better measure for many plans would be the ratio of benefit payments to market value of assets, and we suggest adding that as an additional plan maturity measure for actuaries to consider.

- Section 3.8: As noted earlier in our response to Question 3, we believe that historical information on the maturity measures in section 3.7 should be included among the examples in section 3.8.

- Section 3.9: In response to comments received on the first exposure draft, the ASB might want to clarify that this section is in addition to the current ability of the actuary to rely on separate reports that the actuary has prepared (in accordance with section 3.2 of ASOP No. 41). This would make clearer that section 3.9 simply adds that the actuary may rely on the reports of others when performing a risk assessment.

  We also had difficulty determining the level of review that the actuary needs to undertake before relying on a report from another party (either an actuary or non-actuary). For example, to rely on the results of a stochastic forecast prepared by a plan's investment adviser, could the actuary focus on the reasonableness of the assumptions and methods used without trying to replicate the results? We believe that the level of review should be left to the actuary's professional judgment without requiring the actuary to reproduce the results. It is not clear as written that the actuary could conclude that the work would be consistent without actually replicating the other report.

- Section 4.1: Consistent with our comments on sections 3.2 and 3.3, we believe the identification of risks to be assessed should come before the assessment of those risks. For that reason, we recommend reversing the order of sections 4.1(a) and 4.1(b)

  In section 4.1(b), we suggest that the word "including" be deleted, thus requiring the actuary to disclose all three elements listed in the ASOP (the risks identified, the rationale for selection, and the significance of each).

- Section 4.2: Sections 4.2(a) and 4.2(b) follow the structure and requirements of ASOP No. 41, sections 4.2 and 4.3, respectively. In particular, they refer to assumptions and methods "prescribed by applicable law (statutes, regulations, and other legally binding authority)" and "selected [or set] by another party."

  However, ASOP No. 4 (which was revised three years after ASOP No. 41) makes an important clarification regarding "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." Under ASOP No. 4, such an assumption or method "is not deemed to be a prescribed assumption or method set by law," and so is subject to the more stringent disclosure requirement that ASOP No. 41 applies to assumptions and methods set by another party. See ASOP No. 4, sections 2.20 and 2.21 (definitions).

  Ultimately, we believe that ASOP No. 41 should be amended to incorporate these definitions and related disclosure provisions from ASOP No. 4. In the meantime, we recommend incorporating the clarification from ASOP No. 4 into the proposed ASOP, including the appropriate definitions as required.

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We appreciate the ASB giving consideration to these comments. Please contact Ted Goldman, the Academy's senior pension fellow (202-785-7868; goldman@actuary.org), if you have any questions or would like to arrange a convenient time to discuss this matter further.

Respectfully submitted,

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