October 31, 2016

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

Subject: Second Exposure Draft Proposed Actuarial Standards of Practice - Assessment and Disclosure of Risk Associated with Measuring Pension Obligations and Determining Pension Plan Contributions ('Proposed Risk ASOP')

Dear Actuarial Standard Board:

Thank you for the work of the ASB and the ASB's Pension Committee on the Proposed Risk ASOP. It is an extremely important issue for actuaries to address and it was heartening to see the release of the second exposure draft. Overall, the second exposure draft is an improvement over the first exposure draft.

Below are my comments in the order of the sections of the Proposed Risk ASOP and then answers to the questions posed in the transmittal memorandum.

Section 1.2 – The standard excludes services in connection with benefit suspension applications under the Multiemployer Pension Relief Act of 2014. I did not see an explanation of the rationale for this change. It seems that the consulting work prior to the preparation of such an application would greatly benefit from risk assessments and disclosures. If the rationale for the exclusion is that the format of the application itself is prescribed, then it would be appropriate to exclude all funding valuations and pricing valuation where the format is prescribed by law.

Section 2.1 – The definition of funding valuation explicitly includes a minimum funding valuation but also incorporates the concept of a plan sponsor relying on the valuation. Presumably the definition of funding valuation includes a valuation to determine the maximum deductible contribution. Some plan sponsors do not rely on the minimum funding valuation at all and others have no interest in the valuation which produces the maximum deductible contribution. Some plan sponsors look to the funding valuation to help them decide what to fund to reduce PBGC variable premiums or to make the plan fully funded on a plan termination basis.

If multiple funding valuations are delivered to the plan sponsor as part of the same report, an actuary should generally not be required to perform risk assessments of each funding valuation. To perform risk assessments of each valuation in a single report would not be an appropriate allocation of resources and would provide so much information as to distract from the important information. Instead, any required risk assessment should be performed on the funding valuation that the plan sponsor relies on the most to determine the employer contribution.

The determination of benefit levels appears to be covered under the definition of pricing valuation.

Therefore, I recommend that the text of Section 2.1 be replaced with the following text:

> **Funding Valuation** – A periodic measurement of pension obligations performed by the actuary that the plan sponsor may use to determine employer plan contributions. A funding valuation includes the determination of the minimum required contribution as defined by the Employee Retirement Security Act of 1974 (ERISA) if the plans sponsor is expected to use the results of that valuation to determine the employer plan contributions or no other funding valuation is performed. If multiple funding valuations are provided to the plan sponsor as part of a single report or assignment, the funding valuation for purposes of this ASOP is the funding valuation that the plan sponsor relies on the most in determining the employer contributions.

Section 2.3 – The definition of risk in Section 2.3 better describes the term "Experience Risk." This term would make it clearer which risks are covered by the Proposed Risk ASOP. Additionally, it will make it easier for the ASB to provide guidance regarding other risks at a later date.

The Proposed Risk ASOP definition of risk omits some important risks for funding valuations. For example, some valuations do not require either an investment return assumption or an assumption regarding future employer contributions. For example, a minimum funding valuation under Section 430 does not require an investment return assumption unless an asset smoothing method is used. And, a minimum funding valuation under Section 430 never requires an assumption regarding future employer contributions.

Additionally, the definition of risk as currently stated does not encompass changes in certain assumptions prescribed by law because the changes in the assumptions are not related to actual experience. For example, the segment rates and mortality assumption are prescribed by law. Future measurements will vary based upon the then required assumptions.

Thus, I recommend the following:

- "Experience Risk" replace "Risk" as the term defined in Section 2.3.
- "Prescribed Assumption Risk" be defined as "The potential of actual future measurements deviating from expected future measurements due to Assumptions Prescribed by Law changing."
- "Investment Risk" be defined as "The potential of actual future measurements deviating from expected future measurements due to the investment return being different than expected. In the event that no investment return assumption was necessary for the funding valuation, investment risk shall be assessed by considering the investment return assumption the actuary would have chosen had one been necessary."
- "Subject Risk" be defined as "Experience Risk, Prescribed Assumption Risk, Contribution Risk and Investment Risk"
- "Subject Risk" replace "Risk" throughout the Proposed Risk ASOP as appropriate.

Section 3.2 – As the second paragraph of section 3.2 reads it appears that the list is a mandatory list of considerations. However, some of the items may not be applicable to a plan's risk assessment. As an example, some plans' funding policy are not specific enough to be meaningful in a risk assessment. I recommend that the first sentence of the second paragraph of Section 3.2 be replaced with the following:

> The assessment should take into account circumstances applicable to the plan. Such circumstances may include the plan's funding policy, investment policy, funded status, and plan demographics.

Section 3.3 – Based upon the definition of risk in Section 2.3, the methodology of identifying risks should start with reviewing the assumptions used in the valuation. Each assumption should be reviewed to determine whether variance from the assumption could affect the plan's funded status in an important way.

As noted in ASOP 1, multiple meanings can be attached to "significant". It would be helpful if the meaning of significance here was clarified so that it emphasized relevance. Currently, it could be read to mean size. For some plans, even small actuarial gains and losses may be relevant because they push a plan over or under a particular funding threshold. For other plans, very large actuarial gains and losses may be irrelevant because the plan is well-funded, the plan is small relative to the size of the plan sponsor or the plan only covers the employee-owner of the plan sponsor.

It may be appropriate for the actuary to identify assumptions that the actuary believes to be irrelevant or insignificant to put intended users on notice so that they may inquire further if they believe the assumption may be relevant.

I recommend that the first sentence of Section 3.3 be replaced by the following:

> <u>Identification of Risks to Be Assessed</u> – The actuary should review each assumption used in the funding valuation or pricing valuation to identify Subject Risks that in the actuary's professional judgment are relevant to the plan's financial condition. In determining the relevance of a risk the actuary may consider factors such as the significance on the plan's funded status, the plan's funded status, the size of the plan relative to the size of the plan sponsor or other contributing entities, the employer's ability and willingness to contribute more, and the participant group covered by the plan.

Section 3.4 – The assumption chosen for the risk assessment "should result in one or more plausible outcomes." This constraint is problematic. First, it needs to be clearer from whose perspective plausibility is measured. Second, the requirement on plausibility is misplaced for a risk assessment. Part of the value of a risk assessment may be in identifying remote, black swan risks which on the surface may seem implausible. Additionally, part of the value of a risk assessment may be to demonstrate seemingly implausible outcomes when reasonable assumptions are used. This may be the case with asymmetrical risks or difficult to value plan provisions such as floor offset arrangements.

Section 3.6 – Item b. the size of the plan should be clarified so that it is clearer whether size if measured relative to the size of the plan sponsor, number of participants, dollars in the plan, or another measure.

Section 3.7 – Flexibility is provided to the actuary regarding which plan maturity measures to disclose, but it is not clear whether an actuary has the discretion to include no maturity measure. For some plans, plan maturity measures may not be helpful in understanding risk. This could be the case where the plan is relatively young, the plan is small relatively compared to the size of the plan sponsor and/or the plan sponsor's ability to contribute to the plan is unrelated to the plan's maturity.

Below are my responses to the specific questions posed in the transmittal memorandum.

1. The definition of contribution risk should be included in the definition of Subject Risk as described above.

2. It is appropriate that the actuary recommend an additional risk assessment.

3. Yes. It is appropriate.

I appreciate the opportunity to comment and hope the above comments are helpful. My practice area is pension with a focus on micro-sized to small private-employer pension plans. The above comments represent my personal opinions and do not represent any organization.

Sincerely,

DocuSigned by:
Karen Smith
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Karen Smith

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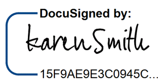
KarenSmith karens@nova401k.com Nova 401k Associates Security Level: Email, Account Authentication (None)	 Using IP Address: 64.9.168.2	Sent: 10/31/2016 10:31:53 AM Viewed: 10/31/2016 10:31:56 AM Signed: 10/31/2016 10:32:13 AM Freeform Signing

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