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Actuarial Standards Board
1850 M Street, NW, Suite 300
Washington, DC 20036
RE: Proposed Revision of Actuarial Standard of Practice No.4

Dear Members of the Board:

As a member of ACOPA, and as a pension actuary in practice for over 45 years, I wish to add my comments and concerns on proposed ASOP 4. My comments are both of a professional actuary and as a private citizen. My experience includes multi-employer and single employer plans of all sizes, and as a speaker educating members of the public on public pension plans.

The most relevant purpose of ASOP 4 is, in my opinion, to require the actuary valuing pension benefits to disclose relevant liabilities of the deferred benefits of the plan or scheme under review. These include benefits already earned and possibly future benefits to be earned.

The users of this information will need to assign these liabilities to relevant periods, both for funding of benefits and for disclosure of potential future events. These may include:

- contribution requirements,
- budgets,
- reassurances to beneficiaries,
- financial viability of principal parties (such as lending risks),
- transfer of responsibility between principals (such as plan terminations, de-risking, lump sum payouts, mergers and spinoffs),
- audit of plan operations including analysis of gains and losses.

**Why do we need this standard?**

This proposed ASOP extends existing standards, especially to include IRDM for plans that have not used such measurement historically. ERISA plans for single employers are already subject to a form of this method of measurement, but with a modified standard for discount rates. If covered by PBGC, the duration-sensitive bond rates of high quality corporate bonds is required. For minimum funding standards under IRC 430, more optimistic rates are required that reflect a long 25 year smoothing of rates.

Under IRC 431, multi-employers plans have currently no such standard. Exempt church plans have no such standard. Public plans have standards set by their governing laws in many plans, but no standard for disclosing the specific funding level of promises already matured as the IRDM would require.

**Practical Concerns**

Plan sponsors, and their interested parties that have not complied with a form of disclosure similar to IRDM in the past, will find that there are consequences of adopting this ASOP 4.

- First, there will be transitional costs for determining the method and format of disclosure.
- Second, the responsible actuary will initially incur additional work until their procedures and business practices can be responsive to the standard.
- Third, the plan sponsor will have more public dialogue explaining the new information, which will result in more administrative expense. This would include discussion of smoothed funding procedures compared to the fluctuations that will occur once ASOP 4 is implemented.
- Fourth, policy makers will be confronted with pressure for change in plan benefits, investment decisions, and commitment to fund promises made. This might affect benefit negotiations as well. As the homily goes: if you find you are in over your head, stop digging.

**I find none of these concerns to be so serious that the profession should back away from a standard that informs the various publics, including beneficiaries.**

The proposed standards might cause policy changes that disrupt established policies, but that is the purpose of a standard that is well understood. Plan sponsors and their advisors do not serve the public or the profession by arguing that these measurements are time-consuming or irrelevant to their operation. Plan liabilities should be tied to the period of time when they emerge, so costs are not hidden and so that funding of benefits corresponds to the events that created the liability.

**Some Historical Perspective**

My history includes many years of experience before the legislated standards set the funding method for private single employer plans. Many of those old funding methods served to set a method of recognizing pension costs that might not have measured current funding status, such as Aggregate, Individual Aggregate, Frozen Initial Liability, and others that were of no use in determining the safety or adequacy of current assets to provide the benefits. Many of the plans currently exempt from ERISA standards have a similar lack of information. The adoption of ASOP 4 as drafted is an important step in full disclosure.

The accounting profession made some improvement in such disclosures for published financial statements when Accounting Standards were issued under FASB Opinion 87, and thus created a standard that measured current funded status under an ongoing-plan scenario. For example, they did require the actuary to disclose some valuable information on how assumptions were set.

This did not create a standard that was sufficient when consideration of settlements of liability transfers is contemplated, as that was the purpose of FASB Opinion 88. Even though disclosures did allocate plan liabilities to past, current, and future liabilities, the standards rarely caused disclosure of market values, since it was usually tied to long term discount rates and expected investment returns. Further, many plans were not subject to these standards.

For public plans, GASB made significant progress in consideration of liabilities and their supporting funds, placing liabilities into two categories, those covered by assets are valued at a long term expected rate, but those not covered by current assets are valued at the rate available to the plan sponsor to borrow in the capital markets. This was a significant challenge to the actuarial providers, but the industry demonstrated that a change of this magnitude could be managed in a timely manner. This lends credence to the point that IRDM can be implemented without undue turmoil.

**Justifications For Discount Rates**

Public discourse includes many different audiences. The investment community became interested in pension funding disclosure after finding that pension liabilities had often been understated before actions were taken, such as derisking, plan termination, and other events where benefits had to be priced to attract principal parties to accept the responsibility of the benefits, and promised financial disclosures proved to be wildly optimistic. Investment theory noted that pension obligations were senior to most other debt, and enforced by PBGC and civil suits brought by participants. It is a widely held view at the national policy level that employers are liable for benefits to the extent of their ability to pay, regardless of other parties and their interest in plan sponsor assets. Failure to fund benefits is a policy action on plan sponsors that has consequences.

However, the consequences cannot be held against entities that no longer have the resources to meet their promises, including bankrupt sponsors. This occurs in all types of public, single employer, multi-employer, and church plans. Disclosure under ASOP 4 of the funded status of a plan is key to solving funding problems as early as possible. This is fully in the public's interest, both for the protection of plan beneficiaries and for those who supply capital assets to plan sponsors.

I observe that IRDM as proposed is based on a risk-free discount rate, which I observe as the most conservative of possible measures. This is consistent with capital market theory in many schools of finance. Other measures have been used, including historical averages of actual investment results, PBGC or IRS published rates, insurance company guaranteed rates, or immunized bond portfolios. In my opinion, each of these rates include some provision for external economic forces, especially inflation expectations, but also market fluctuation in the availability of capital. Some of that is based on market demand for lending, some is based on Federal Reserve policy, or on needs for federal debt, which can affect market demand. I would prefer that liabilities be valued at both a current rate and the prior year rate, so the public has information on the effects of capital market changes.

A market interest discount rate can and usually would fluctuate, sometimes dramatically from year to year, and the choice of discount rate should not be the province of the plan sponsor nor the beneficiaries because of the divided loyalty between participant security and capital market needs, including managing profits.

For the purposes of measurement, I would consider a standard using actual yields less inflation, viewed over a business cycle of at least five years that includes a period of market correction, based on compound yield (geometric mean). This rewards plan sponsors who have a successful record of competent investment management.

However, measurements appropriate for de-risking, settlement, and similar actions should be tied to current pricing models of principal parties who can accept full liability for promised benefits, including PBGC and insurance annuity products. For example, CALPERS uses a model for discontinuing plan sponsors in which earned benefits are valued at a discount rate that CALPERS considers highly likely to achieve, not on expectations that plan sponsors can correct underfunding from future contributions which are no longer available.

**Other Considerations**

One final point: bad examples come from bad policies and standards. Look at plans that have a long spread period to amortize past benefit liabilities, or the temptation of operating groups to generate immediate liabilities and never fund them (e.g., via negative amortization or refusal to pay the actuarially determined cost). Generous bonuses and unexpected compensation increases are often the cause of liabilities that do not fit in the current model used by plans using such funding methods as Entry Age Normal. Few actuaries would consider it reasonable to have an assumption for compensation to double in the year of benefit determination.

To hold the stakeholders accountable for their actions, I believe that IRDM measurement should be applied to individual participants, and those with substantial actuarial liability increases should be charged directly for their actions within the next measurement period as an immediate loss. This is especially true when considering such actions as hiring a senior manager with substantial past service credits, or when paying additional compensation based on overtime or accrued sick leave. The actuary should measure such events and be able to explain what actions caused a sudden liability increase. A version of this policy has been tried in Illinois when compensation grows more than 6%. A policy which ties the budget of an operating unit to their actions is needed.

Thank you for the opportunity to comment.