July 31, 2018

ASOP No. 4 Comments
Actuarial Standards Board
1850 M Street, NW, Suite 300
Washington, DC  20036

Dear Board Members:

I have reviewed the recently released second exposure draft of a proposed revision to Actuarial Standard of Practice (ASOP) No. 4, Measuring Pension Obligations and Determining Pension Plan Costs or Contributions.  I limit my comments to Section 3.11 of the proposed standard:

1. I find that the new “Low-Default-Risk-Obligation Measure” (LDROM) is an improvement over the “Investment Risk Defeasement Measure” (“IRDM”) as previously defined in Section 3.11. The IRDM was essentially an accrued benefit obligation (ABO), and thus fundamentally flawed as a generally applicable measure of risk. The comparison of an ABO measured on a low discount rate with an actuarial liability measured on a higher expected return of plan assets (EROA) was certain to cause confusion and easily be misunderstood. The LDROM is an improvement, because it can be measured using the same immediate gain actuarial cost method as used in the regular actuarial valuation.

2. This is appropriately reinforced by the helpful new language in the introduction to the Standard that “The calculation and disclosure of this additional measure is not intended to suggest that this is the “right” liability measure for a pension plan.”

3. Notwithstanding the improvement by permitting comparable measures, I still believe that this LDROM belongs in ASOP 51 rather than ASOP 4. This is because it truly is a specific risk measure and not an essential measure of Pension Obligations, which is the domain of ASOP 4.

4. I also believe the LDROM should be illustrated as one of many potential risk measures in ASOP 51 and not prescribed. It is inconsistent and an unwise precedent to prescribe a specific measure in an ASOP—particularly one as controversial as this measure. If it must be prescribed, ASOP 51 is the more appropriate place.

5. My reasoning for shifting the emphasis of a LDROM from ASOP 4 to the risk standard of ASOP 51 includes issues of consistency, bias, and transparency that relate to the distinction between Defined Benefit (DB) Plans (where actuaries follow ASOP 4) and Defined Contribution (DC) Plans (often with little actuarial involvement). Sound public policy should foster disclosure that provides an accurate and balanced view of the potential costs to provide adequate benefits under either a DB or DC plan.

a. In a DB plan, the risk is generally related to the possibility that the actual plan costs and liabilities will be different than expected. Actuaries make the calculations of the expected plan costs. A comparison of the liabilities based on EROA with the liabilities based on LDROM may be useful in understanding the risks (along with other risk measures) and the potential costs of providing adequate benefits under various conditions.
b. In a DC plan, the risk is generally related to the account balance being insufficient to provide the anticipated benefit. The participants typically make this calculation (if at all), using a model developed by the administrator of the DC plan. The users of this model would input their EROA, and possibly a lower EROA to get an idea of the risk that they are taking. But individuals would not likely use a rate as low as the LDROM would suggest in order to understand the low benefit levels produced by such an investment strategy.

c. If we do require all DB ASOP 4 calculations to include an LDROM calculation, it would make sense to develop an actuarial standard for actuaries involved in DC benefit estimates that would require their model to automatically include calculations based on LDROM returns also. Failure to do so would be a disservice to the stakeholders, who would assess the adequacy of DC benefits based on only an EROA, but assess DB plan costs and liabilities based on both EROA and LDROM.

d. Many actuaries work for or consult to institutions who would benefit greatly if DB plans were replaced by DC plans. Most DB plans are self-administered, particularly those in the public sector, for whom an LDROM calculation would be a new concept.

e. It is inconsistent and biased to require actuarial firms to calculate DB values based on LDROM while financial institutions can market DC plans without warning their customers that LDROM level returns would produce woefully insufficient retirement benefits or require substantially greater contributions.

f. I understand that it may not be ASB’s responsibility to regulate the DC industry, but shifting LDROM-based calculations to the risk standard (ASOP 51) would lessen the DB/DC comparison inconsistency outlined above and make it clear that it is only one of many potential risk measures and not the “true” measure as often cited by those preferring DC plans to DB plans.

6. Finally, I am a signatory to a group letter from the CCA public plans steering committee and contributed to the AAA Public Plans Committee comment letter of July 10. Please also consider their comments as my own.

I appreciate the opportunity to provide feedback on the proposed revisions to ASOP No. 4 and would be happy to discuss comments in greater detail.

Sincerely,

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