

Comment #15 - May 31, 2012 – 6:44 p.m.

To the Actuarial Standards Board:

This letter responds to Question 2 on page x of the Exposure Draft of ASOP 4: Measuring Pension Obligations and Determining Pension Plan Costs of Contributions. My response to this question is that the language regarding actuarial present value types is not clear, because of the proposed name (as explained below). Instead of 'market-consistent present value', a better term would be 'non-asset-based present value' or 'economic value', the latter of which has already been used in this context in relevant literature.

The exposure draft contains the following paragraph:

3.7.3 Market-Consistent Present Values – Market -consistent present values of pension obligations are types of present values not based on plan assets. A market-consistent present value is one that is consistent with the price at which expected plan benefit payments would trade in an open market between a knowledgeable seller and a knowledgeable buyer. ...

The first sentence of 3.7.3 provides a definition of market-consistent present value that has not been proven to be consistent with an intuitive understanding of the term; i.e., what the market thinks the pension obligation is worth. The key issue is that there is no empirical evidence that the market prices non-traded cash flows such as pensions in the same way as it prices cash flows associated with a security. Unless and until there is such empirical evidence, this definition should not be adopted.

Furthermore, there is not a model proceeding from first principles (e. g., rational, risk-averse market participants maximizing their utility functions) that predicts that the market prices non-traded cash flows in the same way as cash flows associated with a security. The belief that the market prices non-traded cash flows in this way merely reflects a hypothesized parsimony of valuation methods; there is no logical derivation from first principles.

The second sentence in 3.7.3 should refer to a security with associated cash flows being traded. Expected plan benefit payments aren't traded in a market.

Sincerely,

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