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Proposed ASOP – Assessment and Disclosure of Risk  
Actuarial Standards Board  
1850 M Street, NW, Suite 300  
Washington, DC 20036-4601

Dear ASB Members:

### Introduction

First, thank you for the opportunity to respond to your request for comments on the Exposure Draft on a proposed Actuarial Standard of Practice (“ASOP”) on the Assessment and Disclosure of Risk Associated with Measuring Pension Obligations and Determining Pension Plan Contributions.

Second, the comments herein are my own and should not in any way be associated with any of my prior employers.

Third, I would like to make the following, initial observations:

1. The motto of the Society of Actuaries (“SOA”) is “Risk is Opportunity” but, at least in the pension area, actuaries have not provided extensive information and the ASB has offered only modest guidance.
2. While risk is opportunity, few Pension Plan Trustees or Plan Sponsors seek or desire to pay for the risk analyses from which they would benefit.
3. Consequently, an ASOP on the assessment and disclosure of risk could be a valuable tool in the arsenal of pension actuaries in their efforts to properly advise their Clients.
4. That said, any new ASOP on the assessment and disclosure of risk should NOT be overly prescriptive and should be primarily principles based with much discretion left to the individual actuary to use professional judgement as to the extent and details of implementation.
5. It has been said that ASOPs can represent both swords and shields. This may be so but effectively so only if the ASOPs are strong. Inadequately designed or built swords and shields will fail when needed most in a time of battle. The challenge with the proposed risk assessment and disclosure ASOP will be to find the balance.

With all of this said, to its great credit, the Actuarial Standards Board (“ASB”) is asking for input on a proposed ASOP on the assessment and disclosure of risk that could assist actuaries to do the best possible jobs as professionals.

Ultimately, one of the great challenges for the ASB raised by this request for input is for the ASB to balance the benefits of additional risk assessment and disclosure with the demands made on actuaries while also providing adequate assurance to the public that actuaries are doing their part to protect the public interest. As the ASB states in its documents:

*“Standards. Standards of practice serve to assure the public that actuaries are professionally accountable. At the same time, standards provide practicing actuaries with a basis for assuring that their work will conform to appropriate practices. Standards protect the public by:*

- *Indicating for various areas of actuarial practice the appropriate procedures, techniques, and approaches, thereby enhancing the public's trust in the credibility and completeness of the actuarial work product.*
- *Providing a means by which the many separate elements that make up actuarial practice can be reviewed and updated on a regular basis, so that practice remains current.*
- *Furnishing criteria for evaluating actuarial work products.*
- *Providing a basis for discipline in those instances in which standards are not adhered to.*

*For individual actuaries, standards confer major benefits as well, by:*

- *Providing guidance, particularly in practice areas that may be somewhat unfamiliar.*
- *Giving strong evidence to any interested observer that the profession serves the public in an effective and responsible way.*
- *Offering evidence of appropriate professional performance, which constitutes a defense in any civil or professional disciplinary action.*

*Standards of practice also serve to further assure regulatory authorities that they can depend on the actuarial profession to act effectively in the public interest. Written standards of practice, coupled with written provisions for disciplining members, show that a profession governs itself and takes an active interest in protecting the public.”*

I do not envy the challenge faced by the ASB to support the needs of actuaries with the commitment to serve the public but I know the ASB members will do their utmost to meet this challenge.

I do request, however, that the ASB attempt to design any ASOP to require risk assessment and disclosure but to allow the actuary to use professional judgement to carry out the requirements.

### General Observations

Before addressing the specific questions, following are some additional concerns and objectives that I would like to suggest be considered whenever addressing any proposed changes in the ASOPs or other components of professional actuarial practice:

1. Actuaries take pride in being professionals but most push hard against the idea of being fiduciaries or of being decision makers. Even if it is appropriate that actuaries retain the traditional role of being advisors, it may not be consistent with being considered professionals to offer advice that is ignored, watered down or otherwise not followed without some requirement on the part of the actuaries as advisors to raise an alarm.
2. Most actuaries work in areas that involve significant regulation where actuarial practice is constrained and key decisions are geared toward the protection of the ultimate beneficiaries of that practice. For actuaries working on Public Pension Plans, there is less, or sometimes no, real regulation or constraint on actuarial practice.
3. The services of most Public Pension Plan actuaries are provided to agents (in an economic sense) where the ASOPs would currently allow actuaries to consider these entities (e.g. Boards of Trustees to Public Plans) to be Principals (i.e. they pay the bills and receive the advice and reports) and not necessarily address the need of other Stakeholders or the public. Given the ultimate payers and risk takers of most Public Pension Plans can often be the Plan participants (whose benefits and member contribution requirements could be at risk) and are almost always the taxpayers (even unborn taxpayers) who must pay the bills, there may be a need to go beyond the requirements of existing ASOPs to protect those for whom the actuarial services are ultimately impacting (i.e. the Principals).
4. In effect, for most Public Pension Plans, there is no “Policeman” to ensure that good actuarial practice and decision making based thereon occurs. While it may be presumptuous of the actuarial profession to attempt to fill this role, it may also be a dereliction of duty to do otherwise.
5. Thus, my main theme in responding to this Request for Comments is to ask the ASB to consider this larger question of what role should a profession play to protect the ultimate beneficiaries and Stakeholders of the work being provided. I think it may be time, at least with respect to Public Pension Plans, to ask the actuarial profession, via ASOPs promulgated by the ASB, to step into the role of Policeman to protect both the actuarial profession and, more importantly, those who rely on actuarial work.
6. This proposed ASOP on the assessment and disclosure of risk has the potential of providing actuaries, their Clients, other Stakeholders and the public with additional, valuable information on the viability of Pension Plans.

### Responses to Specific Questions

Therefore, following are responses to the specific questions posed:

1. *The Discussion Draft that preceded this proposed ASOP indicated that a risk assessment should be performed for substantially all pension assignments. The Exposure Draft has limited the assessment to funding valuations, as defined in Section 2.1. Do you believe this limitation is appropriate? Why or why not? If not, what other types of valuations should include risk assessments?*

In the Discussion Draft the requirements to perform risk assessments was wide-ranging, possibly too much so.

However, the suggested change to limit such risk assessments to just “Funding Valuations”, as defined in the ASOP, seems too limited.

It would make more sense for risk assessments and disclosure to be provided on any pension financing analyses where the risks of not meeting the assumptions could result in material impacts on the overall financial status of the Pension Plan or its Plan Sponsor.

2. *Does the language in the Exposure Draft provide sufficient guidance to actuaries performing risk assessment work? If not, what additional guidance should be provided?*

The Exposure Draft appears to cover many of the key risks that should be addressed by actuaries performing financial analyses of Pension Plans.

However, in Section 3.2 it might be useful to add to the list for consideration the following risks:

- a. Contribution Risk (i.e., the risk that contribution are not made to a level necessary to provide for adequate funding of the obligations).
- b. Demographic Risk (i.e., the risk that Plan demographics are such that modest differences from assumptions have out-sized impacts on the financial status of the Plan, such as when a Plan of mostly retired participants is invested heavily in equities and the equity markets underperform).
- c. Plan Sponsor Risk (i.e., the possibility that the Plan Sponsor, due to declining resident population, revenue stress or other issues, may not be able to support the financial requirements of the Plan).

Even if beyond the expertise of the actuary to fully evaluate all of the risks mentioned in Section 3.2, in particular the budgetary risks related to the Plan Sponsor, it is important that the actuary not ignore that these risks do exist.

3. *Is the language in the exposure draft sufficiently flexible to allow for new developments in this area of actuarial practice?*

Yes.

4. *Do you agree that the guidance in Section 3.3 regarding assumptions used for the assessment of risk should include moderately adverse but plausible outcomes? If no, what guidance would you propose?*

No, the language is too prescriptive.

While the language may be intended to avoid the presentation of only extremely adverse scenarios, it may result in limiting alternative scenarios to those that are only modestly adverse. In that case, the real risks could appear less threatening than they should and the actuary might later be accused of making the risks appear modest when they really were not.

5. *As discussed in Section 3.5, for a funding valuation of a plan, the actuary should perform a risk assessment, which may be quantitative, qualitative, or both. Should the guidance require the actuary to use professional judgment in choosing which type of assessment (quantitative, qualitative, or both) to use? For example, if an actuary believes a quantitative assessment should be performed, do you believe providing a qualitative assessment instead of a quantitative assessment should be considered appropriate actuarial practice?*

The actuary should be allowed the discretion of decided what type of assessment to use. If the professional judgment of the actuary is that there should be a quantitative assessment made, then the ASOP should provide the actuary with the support to insist that it be performed.

6. *Plan maturity measures have been included as a potential disclosure item to assist intended users in understanding the risks associated with the plan. Are there additional measures that may be disclosed that are significant to understanding the risks of the plan? If yes, what measures would you recommend as a disclosure item?*

The presentation of Plan maturity measures could be amongst the most useful fundamental measures provided.

However, while it is important and useful to actuaries and sophisticated users of actuarial information, the presentation of actuarial measures such as Actuarial Accrued Liability (“AAL”), burdened by being “used-this-way-only-by-actuaries” terminology, is not usually well-understood by most users.

The presentation of basic demographic measures of Plan maturity, such as the ratio retired participants to active participants (or retired participants as a percentage of all participants), compared with overall averages, while still confusing, at least offers more users something with which they can associate. The continual national discussion on Social Security sustainability has made such statistics better understood than most actuarial terminology.

Where actuarial terminology is to be used, providing some kind of Asset Volatility Ratio (e.g. Market Value of Assets to Payroll) and some kind of a Liability Volatility Ratio (e.g. AAL to Payroll) may be useful.

While it may be difficult to determine for many Plans, to the extent it is possible, providing some ratios as percentages of annual Plan Sponsor annual budgets could also help Plan Sponsors and the public better appreciate the burdens of Public Pension Plans.

The ASB may wish to look at the report by the SOA Blue Ribbon Panel on the Funding of Public Pension Plans and the some work by the SOA Social Insurance and Pension Finance Section on suggested disclosures for Public Pension Plans for some further ideas on risk disclosures.

7. *Do you agree with the use of a threshold for requiring mandatory quantitative assessment that is based on the actuary’s professional judgment? If not, what threshold do you believe should be used?*

No. This section of the proposed ASOP is overly prescriptive.

Circumstances differ and it should be left to the professional judgment of the actuary as to when, how much and in what way risk assessment is undertaken.

That said, the ASOP would benefit the actuary if it made clear that the work of the actuary would be deficient if the actuary did not render professional judgment on risk assessment and disclose that risk exists, has been considered and, as needed, disclosed.

8. *Do you believe that the term “large plan” in Section 3.7 is sufficiently clear that an actuary will be able to apply it in practice? If not, what clarification would you suggest? Are there other characteristics that should be specified in determining “large plan”?*

No.

Or, more specifically, attempting to specify by Plan size, to be determined on specific schedules, exactly what (e.g. quantitative) risk assessment should be performed is too prescriptive.

Any ASOP on risk assessment and disclosure should be primarily principles based with significant deference to the exercise of professional judgment.

That said, again, it is also important that the professional judgment of the actuary be required and supported in any ASOP.

9. *Is every five years an appropriate period for performing a mandatory quantitative assessment for a “large plan” in the absence of significant changes, as described in Section 3.7?*

Not necessarily. See response to Question #8.

However, much like periodic actuarial studies of demographic and economic experience, more significant evaluations of risk should occur over some intervals that are not too long. The choice of such intervals and the extent of such analyses should be left mostly to professional judgment.

For the actuarial profession is to adequately serve the public, as well as its Clients, it may have to ask more of its practitioners and its Clients. If Clients have only what they want and do not have other information that could be of value to them (of which they may not even be aware) and do not have other information that would likely be of value to them and to other Stakeholders, then they and the other Stakeholders may not be receiving a proper level of professional advice.

I again commend the ASB for proposing an ASOP on the Assessment and Disclosure of Risk Associated with Measuring Pension Obligations and Determining Pension Plan Contributions. While I would prefer that any ASOP be primarily principles based and allow for significant professional judgment, having an ASOP on risk assessment and disclosure that supports actuaries to provide this work should be helpful to the actuaries, their Clients, other Stakeholders and the public at large.

Thank you again for seeking input on this important topic of risk assessment and disclosure as it impacts the role of actuaries in providing professional services to Pension Plans.

Yours truly,

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