

6 Buckingham Drive
Princeton, NJ 08540
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ASOP No. 4 Revision
Actuarial Standards Board
1850 M Street, NW, Suite 300
Washington, DC 20036

Re: Comments on ASOP4 Exposure Draft

Dear ASB Members:

First, thank you for the opportunity to comment on the *Proposed Revision to Actuarial Standard of Practice (ASOP) No. 4* ("ASOP4"). The comments herein are my own alone.

Second, under the Request for Comments section of the Exposure Draft transmittal memorandum are some questions to which the Actuarial Standards Board ("ASB") states it "would like to draw the reader's attention". Following are those questions raised by the ASB with the issues/questions shown, followed by my responses shown in *italics*:

1. Section 3.11, Investment Risk Defeasement Measure, requires the calculation and disclosure of an investment risk defeasement measure when the actuary is performing a funding valuation. The guidance allows for discount rates to be based upon either U.S. Treasury yields or yields of fixed income debt securities that receive one of the two highest ratings given by a recognized ratings agency. Are these discount rate choices appropriate? *Yes and no. The use of U.S. Treasuries yields as a discount rate is appropriate. The use of "yields of fixed income debt securities that receive one of the two highest ratings given by a recognized ratings agency" is NOT appropriate.*

If not, what rate choice would you suggest? *Only the use of U.S. Treasury yields is appropriate if the intent is to have a measure (called by the ASB an Investment Risk Defeasement Measure ("IRDM")) whose calculation would provide to help evaluate the level of investment risk being taken by a Pension Plan.*

Note: First, I strongly favor the disclosure of an IRDM. I do, however, also feel strongly that referring to this measure as an Investment Risk Defeasement Measure puts too much emphasis on only one of its uses. It would be better to refer to this measure, which represents the economic value of a projected stream of promised benefits earned to date, as a Solvency Liability, a Secured Accrued Benefit Liability ("SABL"), a Guaranteed Accrued Benefit Liability ("GABL"), a Defined Accrued Benefit Liability ("DABL"), a Promised Accrued Benefit Measure ("PABM") or something similar. The greatest advantage of disclosing such a measure is that it represents the economic value of the accrued benefits, assuming they are sure to be paid.

As defined, the IRDM can be utilized to evaluate the level of investment risk being taken. However, to do so best would require comparing that IRDM with an Actuarial Accrued Liability (“AAL”) determined based on the Traditional Unit Credit (“TUC”) Actuarial Cost Method (“ACM”), where the accrued benefits are discounted at the expected rate of return on the Plan investments. This TUC AAL should be easy to compute since the accrued benefit cash flows would likely already exist from determining the IRDM. Nevertheless, given that most Public Plan actuaries utilize the Entry Age ACM, for many actuaries, making the more precise comparison could mean a second step would be required.

In summary, I believe that publishing an IRDM is a great idea, but I feel that IRDM is a poor choice of name and emphasizes only one possible use for this valuable measure. It would be better to refer to the IRDM using a name that suggests the economic value that it represents. This measure is a useful one that can stand on its own. Hereafter in this letter I shall refer to the economic value of accrued benefits (i.e. the IRDM) as a Solvency Liability.

- 2. Under certain circumstances, section 3.20, Reasonable Actuarially Determined Contribution, requires the actuary to calculate and disclose a reasonable actuarially determined contribution. Do the conditions in this section describe an appropriate contribution allocation procedure for this purpose? Generally, yes. However, the range of what might be considered a Reasonable Actuarially Determined Contribution (“RAD”) appears to be extremely wide.*

If not, what changes would you suggest? Consideration should be given to placing limitations on how long an amortization period could be used for funding an Unfunded Actuarial Accrued Liability (“UAAL”) to compute a RAD. For example, it might make sense to not allow the amortization period to go beyond the average remaining working lifetimes of the active Plan participants (e.g. by using an Aggregate Actuarial Cost Method Spread Factor or something simpler) or by using a maximum fixed period that is comparable to average remaining working lifetimes of all active Plan participants.

In addition, for computing a RAD, consideration should be given to requiring UAAL be amortized using level dollar payments, not level percentage of payroll payments.

Further, a RAD should consider being based on a common discount rate that might be determined as the sum of a default-free rate (e.g. 10-year U.S. Treasury Spot Yield) plus a fixed adjustment for investing in riskier assets (e.g. 3.3% per year for a portfolio of 60% equity-like assets with an expected real rate of return of 4.5% per year above U.S. Treasuries and 40% fixed-income-like assets with an expected real rate of return of 1.5% per year above U.S. Treasuries).

Note: If this approach is chosen, it would be appropriate to develop a more refined (e.g. consider asset return correlations, etc.), but not too refined (e.g. ignore alternatives), forward-looking (i.e. NOT just based on historical results as the 21st century is likely going to differ from the 20th century due to the impact of increasing debt and aging demographics) estimate for future returns.

Finally, it may be worthwhile to consider requiring the computation of a RADC in virtually all cases, regardless of whether the actuary is following prescribed assumptions or methods set by law.

Third, following are some additional remarks/comments for consideration:

1. Use of ASOPs: *ASOPs are presented often as representing swords and shields to help actuaries produce better work and then defend it. However, at least for Public Pension Plans and Multiemployer Plans, much actuarial work is performed for agents (e.g. intermediaries such as Boards of Trustees, Plan Administrators, labor representatives, Plan Sponsor representatives, etc.) who are not the ultimate bearers of the economic impact of their decisions (e.g. taxpayers, primarily future taxpayers and, alas, when things go badly, Plan participants whose benefits get cut).*

It is often the actuaries who are expected to defend Pension Plan funding. Without strong requirements of the actuaries, it is extremely easy for those actuaries to defer to pressure from the agents, ALL of whom seem to prefer lesser funding now. Alas, I am concerned that even where actuaries protest that they are not succumbing to pressure, most might admit that they are often utilizing the upper end of their "reasonableness" ranges.

2. Actuarial Responsibilities and Risks: *As noted, actuaries are often not the decision makers on the actuarial assumptions and methods employed to determine financial commitments to many Public and Multiemployer Pension Plans. In these cases, actuaries may, nevertheless, be perceived by the public as responsible (i.e. the actuaries are the experts) and subject to ridicule if they try to hide behind the "it was not my decision" defense when things go wrong. This suggests that having strong actuarial standards is important to protect, not just the actuaries, but Plan participants, the public and everyone else involved with Pension Plan financing.*

Pension actuaries have excellent budgeting models but generally do not embrace disclosing the economics of defined benefit pension plans, putting the entire actuarial profession at risk should the day come when Pension Plans fail, and the economic value of the benefit promises exceeds the reported "actuarial liabilities".

3. Amortization Methods: *Prescribing amortization methods and periods should not be necessary, but actuaries should be required to evaluate and comment upon the implications of whatever amortization methods and periods are used (negative amortization, in particular).*

For example, many Public Pension Plan actuaries are comfortable with long-period, payroll-related, increasing-dollar amortization of any Unfunded Actuarial Accrued Liability (“UAAL”). In some cases, these UAAL amortization schedules may clearly be inconsistent with the demographics of the Plan Sponsor (e.g. Detroit). Consequently, it may make sense to require the presentation of contributions based on some philosophically-based, often more conservative, amortization schedules.

If Intergenerational Equity suggests that financing retirement benefits should occur over the working lifetimes of employees, this might be a useful benchmark for developing a UAAL amortization schedule (i.e. amortization over the remaining working lifetimes of active employees) and actuaries should speak to this and to the implications of failing to do so when Unfunded Actuarial Accrued Liabilities exist.

4. *Actuarial Assumptions: Specific guidance should not be necessary. That said, I agree with the proposed requirement that an actuary should evaluate and comment on the appropriateness of the actuarial assumptions being used. I further believe that an actuary should do such an evaluation and make such comments, whether the actuary establishes the assumption or not.*
5. *Alternative Liability Measures: While much should be left to professional judgment, it would benefit actuaries, their clients and the public to see the disclosure of a market-consistent determination of the value of benefits earned to date, sometimes referred to as a Market Value Liability (“MVL”). In my work, I have often referred to this type of calculation as a Market Value Accumulated Benefit Obligation (“MVABO”). For most Public Pension Plans, where the risk of benefit default is minimal, the MVABO is virtually identical to the Solvency Liability (i.e. this term was defined in the 2006 Pension Actuary’s Guide to Financial Economics) and, in the U.S., can be determined by discounting a projected stream of accrued benefits using U.S. Treasury Spot Yields.*

Going forward, I believe that all pension actuaries should be disclosing a Solvency Liability whenever they provide information on Pension Plan financing. The ASB may wish to call it something else (e.g. a Promised Accrued Benefit Liability (Measure)) but please do not call it an Investment Risk Defeasement Measure, as this term is too limiting. As stated earlier, the Solvency Liability measure has uses far beyond just investment risk analysis. It is a measure of the economic value of promised benefits, something of which all Stakeholders should be aware.

Importantly, having actuaries provide such information would mean that the information is more accurate than that produced by non-actuaries. It would also demonstrate that actuaries understand the economics of defined benefit pension plans and that actuaries are not just providers of budgeting models.

In case of concern about misuse or negative connotations, please note that the MVABO measure (calculated as equal to the Solvency Liability) was presented annually from June 30, 2003 to June 30, 2014 in the Comprehensive Annual Financial Report ("CAFR") of each of the New York City Retirement Systems ("NYCRS"). While the press would occasionally utilize the MVABO to highlight the significant economic value of defined benefits and question whether they were too expensive, the world did not end, nor did the City of New York end, just because these numbers were published.

6. *Projected Benefit Streams: In addition to providing a Solvency Liability measure, it would also be worthwhile if actuaries were encouraged (required) to disclose a projection of the accrued benefits.*

This is particularly important if the ASB should decide against requiring the disclosure of a Solvency Liability. There are multiple other users of Pension Plan financial information who, if not provided with a Solvency Liability measure and/or some other economically-realistic measure of pension obligations, try to develop their own.

As the economic value of a stream of pension benefits is NOT dependent upon what assets are used to finance them, the disclosure of a projection of accrued benefits would, at least, provide the building blocks that economists and other financial users are seeking and allow them to make better estimates.

7. *Economic Normal Cost: It would also be worthwhile to require disclosure of an economic Normal Cost (i.e. the expected increase in Solvency Liability for the next year).*
8. *Definitions Section: Whether it is the IRDM or a renamed Solvency Liability (or other), the term should be placed into the Definitions section of the ASOP.*
9. *ASOP27 and ASOP35: To the extent any of the comments herein on the ASOP4 Exposure Draft should be applicable to the ASOP27 and/or ASOP35 Exposure Drafts, please consider them therewith.*

Finally, thank you again for the opportunity to comment and for your consideration.

Yours truly,

Robert C. North, Jr.