AMERICAN ACADEMY *of* ACTUARIES

May 31, 2013

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

Re: **Comments on ASOP No. 4, *Measuring Pension Obligations and Determining Pension Plan Costs or Contributions***

Members of the Actuarial Standards Board:

On behalf of the Pension Finance Task Force[1] (PFTF), which is sponsored jointly by the American Academy of Actuaries and the Society of Actuaries, I welcome this opportunity to comment on an exposure draft that relates closely to our mission. The PFTF's mission is to bring the insights of financial economics into the mainstream of pension actuarial practice.

The Exposure Draft of Actuarial Standard of Practice No. 4 -- *Measuring Pension Obligations and Determining Pension Plan Costs or Contributions* (ASOP 4) addresses several topics. Our primary concern continues to be with just one of those topics, the proper measurement of pension obligations. For that purpose, we have recommended to the ASB and in other forums, the use of market liability values. We are pleased to note that the Exposure Draft (ED) recognizes market liability value, although under the name of "market-consistent present value."

We suggest the following:

- "Market value," rather than "market-consistent present value," is the appropriate term.

  "Market value" is used consistently and, we believe, universally outside the actuarial profession with respect to the entire spectrum of economic goods – from those traded on liquid markets to those traded infrequently such as corporate bonds, private businesses, or homes. "Market value," no less than "market consistent value," is a term of art since it applies to the valuation of assets and liabilities for which there may be no observable market.

[1] The American Academy of Actuaries is a 17,000-member professional association whose mission is to serve the public and the U.S. actuarial profession. The Academy assists public policymakers on all levels by providing leadership, objective expertise, and actuarial advice on risk and financial security issues. The Academy also sets qualification, practice, and professionalism standards for actuaries in the United States.

Pension cash flows are an economic good that have a market value that can be estimated just as the market value of a bond that has not recently traded can be estimated. Substitution of the term "market-consistent present value" for "market value" in actuarial literature only serves to isolate actuaries from other participants in financial markets.

We understand that the term "market-consistent" has gathered traction in other actuarial practice areas but not been formalized in the ASOPs. Although it may seem a minor point, we believe that actuaries benefit from speaking the same language as professionals in related fields. The importance of the careful selection of terminology is demonstrated by the pension practice's entrenched use of the word "liability," which conflicts with both general usage and its accepted meaning in other professions.

- Section 3.11 should indicate that the market value of pension cash flows should be consistent with the value of market traded cash flows (e.g., bonds, strips, swaps) that are similar to the pension cash flows in amount, timing and probability of payment.

  The wording above reflects what we believe is the universally held view of financial market participants on how to value cash flows. There are consequences to this definition that affect other parts of Section 3.11.

  - The actuary should (not "may" as the ED would have it) "consider how benefit payment default risk or the financial health of the plan sponsor affects the calculation." In addition to the credit-worthiness of the party or parties obliged to make good on the pension promise, the valuation needs to reflect (a) collateralization from segregated plan assets, and (b) that pension payments may have a de facto higher standing in bankruptcy than unsecured unfunded pension liabilities. It follows that for most qualified pension plans backed by a trust, the discounting would occur at close to risk-free rates, but for most nonqualified pension plans, the discounting would be valued similarly to unsecured debt of the sponsor. In any case, it is essential for the actuary to take the probability of payment into account.

    Discounting the pension cash flows at discount rates that do not reflect the creditworthiness of the obligor is useful for other purposes (i.e., discounting at "risk-free" rates or determining a solvency value); it is merely that such value shouldn't be referred to as the market value of the obligation.

  - The market value of a pension cash flow is neither determined by (1) using a high-quality corporate bond curve or reference portfolio, nor by (2) discounting using the expected return of assets on an asset portfolio, unless such method duplicates the value determined under the basic definition of market value.

- We read Section 3.11 (b) as implying that a market value calculation only applies to an accrued benefit-type cash flow (e.g., ABO). Was this intended? If the ASB believes "market values" should be based on ABO-type cash flows only, then we understand that it would still be permissible to discount using projected cash flows (e.g., PBO) as described above, as long as the result was not labeled "market value."

The transmittal letter for the second exposure draft of ASOP No. 4 recognizes the need for coordination between ASOP No. 4 and ASOP No. 6. Given that the comment period for the second exposure draft of ASOP No. 6 remains open through the end of August, we recommend that the ASB not finalize ASOP No. 4 before carefully considering any related comments on ASOP No. 6.

Thank you for considering our views.

Sincerely,

Gordon J. Latter, FSA, MAAA
Chairperson, Pension Finance Task Force
American Academy of Actuaries
Society of Actuaries