October 1, 2012

Pension Committee
Actuarial Standards Board
1850 M Street, NW, Suite 300
Washington, DC 20036

RE: Comments on the Risk-Related Discussion Draft

To ASB Pension Committee:

The Pension Practice Council of the American Academy of Actuaries has reviewed the Discussion Draft, Assessment and Disclosure of Risk Associated with Pension Obligations, Plan Costs, and Plan Contributions, as released by the Pension Committee of the Actuarial Standards Board in June 2012. This letter summarizes the issues and concerns that we have identified regarding the Discussion Draft.

Expansion of Actuary’s Responsibilities

The proposal outlines an array of responsibilities for a retirement plan actuary to communicate about the risks and uncertainties involved in the valuation of a retirement plan. The new standard would supplement or replace an array of risk-related communication requirements that either are already specified in the ASOPs or proposed in exposure drafts of ASOPs 4 and 41.

As we understand the Discussion Draft, the standard would require actuaries to quantify/assess the potential range and consequences of adverse future results in any assignment that involves the quantification of retirement plan obligations, costs or contributions.

All knowledgeable parties can agree that there is substantial uncertainty involved in most retirement plan calculations due to the broad array of assumptions that are made, almost none of which are certain to be borne out. Taking at least some steps to ensure that the users of an actuarial work product are aware of the uncertainty involved is certainly advisable. The key decision, however, is how much additional work can be required of actuaries in performing substantially all actuarial assignments.

When viewed from a practical perspective, requiring an actuary to do a rigorous assessment of future volatility represents a very substantial increase in scope for the typical assignment. In some cases actuaries may have the knowledge, tools, budget and authorized project scope to perform these kinds of assessments on a routine basis. However, in our view this is not generally

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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.
the case. For that reason, making this type of analysis a requirement of a professional work product will likely prove to be very problematic.

What an Assessment of Risk Would Require
Possible types of analyses identified are stress tests, scenario tests or stochastic modeling. We view the first two analyses as being essentially the same thing, with the third representing a somewhat more rigorous approach.

The Pension Committee opines that an assessment of risk anticipated by the standard would not require exhaustive analysis or sophisticated risk modeling tools. We believe that in order to be meaningful a risk assessment would need to be fairly sophisticated and at least somewhat rigorous, i.e., we do not envision a meaningful risk analysis being a simple exercise.

In order to present a relevant appraisal of future volatility/risk the actuary would need to consider the specifics of the plan’s financial strategies in the context of a robust and rigorous capital market model. Accordingly, we do not believe that doing something simple and routinized along the lines of “what happens if returns are higher or lower by 10%” or “what if interest rates go up or down by 2%” would suffice as truly relevant assessments of risk. The problem with relying on such simplified analyses is that they are not helpful in assessing the probability of adverse results occurring, and fail to consider critical risk determinants such as the impact of investment policies, asset/liability alignment strategies and the impact of time horizon.

We also note that the definition of risk as losses or shortfalls compared to expectations may be overly limiting, in that whether a particular outcome is viewed as problematic may depend on the perspective. It may be preferable to employ a definition that references variance from expectations in any direction.

Identifying/Classifying the Sources of Risk
Five sources of risk are identified – investment, asset/liability mismatch, interest rate, longevity and other. While each of these seem relevant when viewed independently, there seems to be a problematic overlap or redundancy present in this list when viewed in totality, in that the assessment of investment or interest rate risks necessarily invokes the alignment of assets and liabilities. Thus, listing the “mismatch” issue as a separate item seems problematic.

In order to address this overlap issue, it might be best to (a) drop the second item (asset/liability mismatch) and (b) indicate that the investment and interest rate risk items are to be representative of the impact of investment and interest rate volatility on the plan (which is likely what is implied anyway).

Risk Related to Sponsor Viability
No standard currently requires the actuary to assess the impact of a plan sponsor’s financial viability on the financing of the retirement plan. The question is asked whether this proposed standard should do so.

The program sponsor’s financial strength and the correlation of the sponsor’s financial well-being to the capital market and other events that could cause financial stress for the retirement program are certainly very relevant issues to a comprehensive assessment of risk, since both elements affect the reliability of a sponsor’s commitment to pay future contributions when
needed to make up potential future funding shortfalls. Thus, any assessment of risk to the plan should reasonably be considered in the context of the plan sponsor’s ability to shoulder that risk.

However, requiring the actuary to perform what is essentially an “enterprise risk” evaluation that extends beyond the plan’s financials to encompass an analysis of the sponsor’s business operations would be a very substantial expansion of the actuary’s responsibilities. Beyond the impracticalities related to the expansion in scope of a typical project, it may also be unrealistic to presume that such assessments could be delivered by retirement plan actuaries given their level of training and the information made available to them as part of the valuation assignment.

**Application to OPEB Plans**
The stated intention is to apply the provisions of this standard to retiree welfare benefits. We believe that this broader scope requires a bit more focus on the risks specifically entailed by retiree welfare plans and how those risks differ from those entailed by pension plans. Assuming that is done, the piece should probably be relabeled more generically, e.g., to cover “retirement plans” rather than “pension plans.”

**Other/Miscellaneous Comments**
- The definition of risk outlined in Section 2.1 may be overly limiting in that it refers to the “potential of future losses or shortfalls.” Any valid assessment of risk would of course need to address both the probability and consequences related to the potential range of future experience.

- The connection of a risk assessment to any particular valuation assumption seems rather tenuous. The types of volatility analyses proposed to be performed by the actuary are not restricted to the impact of any one particular assumption, but rather apply to the plan as a whole and the totality of its future experience. For this reason, the fact that a given assumption may be “prescribed by applicable law” does not seem very relevant to the requirement for an actuary to perform a risk assessment. Said another way, the plan bears financial and demographic risks no matter how the assumptions are set. We would also note that in many cases there are options available for setting assumptions even when those assumptions are prescribed.

- A similar issue arises with the exemption for “reliance on other sources.” Again, there is risk that is relevant to the plan’s future viability that could be quantified regardless of how a particular assumption is set.

- We believe that any requirements for risk assessment should apply equally to actuarial reports performed with regard to social insurance programs.

**Defining a More Feasible Approach**
Other ASOPs – specifically ASOPs 4 and 41 (relevant excerpts attached) – address the analysis and communication of risk. Their requirements are of course much less rigorous than what is proposed in this document. While, as already noted, we are not convinced that the actuary should be required to quantify the risk aspects with each assignment, we do believe that a discussion of the risk elements might reasonably be required.

The required disclosures related to risk might be expanded beyond what is currently defined in the existing ASOPs. Such expanded disclosures might be viewed as more or less appropriate
depending on the purpose of the measurement. For example, a focus on volatility-related considerations might be more relevant in the case of forecast studies, i.e., where results go beyond the presentation of point-in-time measurements, and less necessary in reports whose focus is more limited, such as a valuation report that addresses statutory requirements.

In any event, the requirements of all relevant ASOPs would need to be coordinated so as to avoid uncertainty and confusion about what is required.

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We again thank you for affording us this opportunity to provide feedback on the discussion draft. We would be pleased to provide additional detail on any of these comments. Please contact David Goldfarb, the Academy’s pension policy analyst (202-785-7868, goldfarb@actuary.org) if you have any questions or comments.

Sincerely,

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Vice President, Pension Practice Council
3.3 Disclosures Within an Actuarial Report
Consideration of the items to be disclosed is an important part of the preparation of any actuarial communication.

3.3.1 Uncertainty or Risk
The actuary should consider what cautions regarding possible uncertainty or risk in any results should be included in the actuarial report.

4.1.3 Disclosures in Actuarial Reports
Any actuarial report should disclose the following information unless it is inappropriate to do so:

 ASOP 4 Draft

Purpose of Measurement
3.3.3 Risk or Uncertainty—Consistent with section 3.4.1 of ASOP No. 41, the actuary should consider the risk or uncertainty inherent in the measurement assumptions and methods and how the actuary’s measurement treats such risk or uncertainty.

3.15 Volatility—If the scope of the actuary’s assignment includes an analysis of the potential range of future pension obligations, costs, contributions, or funded status, the actuary should consider sources of volatility that, in the actuary’s professional judgment, are significant. Examples of potential sources of volatility include the following:

a. plan experience differing from that anticipated by the economic or demographic assumptions, as well as the effect of new entrants;

b. changes in economic or demographic assumptions;

c. the effect of discontinuities in applicable cost or funding regulations, such as full funding limitations, the end of amortization periods, or liability recognition triggers;

d. the delayed effect of smoothing techniques, such as the pending recognition of prior experience losses; and

e. patterns of rising or falling cost expected when using a particular actuarial cost method for the plan population.

In analyzing potential variations in economic and demographic experience or assumptions, the actuary should exercise professional judgment in selecting a range of variation in these factors and in selecting a methodology by which to analyze them, consistent with the scope of the assignment.

4.1 Communication Requirements
i. the type of actuarial present value contained in the actuary’s work product (plan-asset-based or not based on plan assets as described in section 3.7) and a general description of the implications of the chosen actuarial present value type. For example, if the present value is asset based, the actuary may include a statement that the use of such values may create incentives to adopt riskier investment policies that increase expected return and lead to lower reported cost or improve the plan’s reported funded status. As another example, if the actuarial present value is not based on
plan assets, the actuary may include a statement that such present values are often volatile from one year to the next and may create incentives to adopt investment policies that attempt to track the movement of the actuarial present value measurement;

q. a statement, appropriate for the intended users (as defined in ASOP No. 41), indicating that future measurements (for example, of pension obligations, costs, contributions, or funded status as applicable) may differ significantly from the current measurement. For example, a statement such as the following could be applicable: “Future actuarial measurements may differ significantly from the current measurements presented in this report due to such factors as the following: plan experience differing from that anticipated by the economic or demographic assumptions; changes in economic or demographic assumptions; increases or decreases expected as part of the natural operation of the methodology used for these measurements (such as the end of an amortization period or additional cost or contribution requirements based on the plan’s funded status); and changes in plan provisions or applicable law.”

In addition, the actuarial communication should include one of the following:

1. if the scope of the actuary’s assignment included an analysis of the range of such future measurements, disclosure of the results of such analysis together with a description of the factors considered in determining such range; or

2. a statement indicating that, due to the limited scope of the actuary’s assignment, the actuary did not perform an analysis of the potential range of such future measurements;