



AMERICAN ACADEMY *of* ACTUARIES

October 27, 2005

ASOP No. 4 Revision
Actuarial Standards Board
1100 Seventeenth Street, NW, 7th Floor
Washington, DC 20036-4601

Re: Comments on the 2nd Exposure Draft of ASOP No. 4, *Measuring Pension Obligations and Determining Pension Plan Costs or Contributions*

Ladies and Gentlemen:

On behalf of the American Academy of Actuaries'¹ Pension Accounting Committee, I appreciate the opportunity to comment on the second Exposure Draft of ASOP No. 4, *Measuring Pension Obligations and Determining Pension Plan Costs or Contributions*. Members of the committee have provided the following list (by section) of issues for the ASB to consider.

- 2.1 and 2.2 The intent of the last sentence of each subsection is unclear. We do not believe it is appropriate to discuss the treatment of expenses in a definition. We suggest that these sentences be deleted and the treatment of expenses be discussed in subsection 3.10c.
- 2.5 The term "amortization approach" is not used in this document, and we do not believe this term is used in practice. We suggest that the term be changed to "amortization" and defined as the means of allocating an amount at a single point in time into an equivalent series of payments over a specified period of time.
- 2.6 This definition appears circular, with "contribution" (or variants) used several times in the definition. We suggest the definition be re-written as "an actual or potential payment from a plan sponsor or other interested entity to a benefit plan."
- 2.13 We suggest removing the words "or is expected to satisfy" from this definition. Someone who is expected to satisfy the participant requirements is a potential participant or (as used in 3.6.1) an employee "who might become a participant in the future."
- 2.14 We concur that an actuary should not be required to reflect plan provisions or administrative practices that are unknown to the actuary. However, it is counter-intuitive to define plan provisions or administrative practices as those that are necessarily known to the actuary. We suggest that, similar to ASOP No. 23 (sections 3.4 and/or 3.6), this ASOP specifically include text that provides that the actuary is not expected to reflect plan provisions or administrative practices that are reasonably unknown to the actuary.
- 3.1 The words "this standard" at the beginning of the second sentence of the fourth paragraph can be read to refer to either the proposed ASOP on asset valuation methods (the last standard mentioned in the preceding sentence) or this ASOP No. 4. We suggest that "this standard" be replaced with "ASOP No. 4."

We concur that ASOP No. 4 should govern to the extent of any conflict with ASOP No. 27, ASOP No. 35, and the proposed ASOP on asset valuation methods.

¹ The American Academy of Actuaries is the public policy organization for actuaries of all specialties within the United States. The Academy is nonpartisan and assists the public policy process through the presentation of clear, objective analysis, and serves as the public information organization for the profession. The Academy regularly prepares testimony for Congress, provides information to federal officials and congressional staff, comments on proposed federal regulations, and works closely with state officials on issues related to insurance. The Academy also supports the development and enforcement of actuarial standards of conduct, qualification and practice and the Code of Professional Conduct for all actuaries practicing in the United States.

- 3.2 We concur that use of a prescribed assumption does not relieve the actuary of all responsibility regarding the reasonableness of the assumptions. However, the word “consider” (in the first sentence) is vague. We suggest that the word “consider” be replaced with “evaluate the reasonableness of.”
- 3.9 Sections 3.9.1 and 3.9.2 appear to present an exhaustive list of the measures of pension obligations. There may be others, such as a measure similar to that described in 3.9.1.a but without the reduction for benefits not fully vested (3.9.1.a.1). We suggest that this section be clarified to allow for other measures of pension obligations.

In some situations the legislative/regulatory authority may require a specific Actuarial Cost Method that differs from the methods presented. In those situations it should be clarified that a calculation meant to comply with specific rules should follow the rules promulgated by the legislative/regulatory authority.

- 3.9.1.b The alternatives to accrued benefits (3.9.1.b.4 i – iii) do not consider situations of uneven or backloaded formulas. We do not agree that the pattern of accrual suggested by the plan provisions is necessarily preferable, nor do we agree that the proration by service to full vesting is preferable to proration by service to anticipated separation from service.

For example, consider a benefit formula that provides for immediate vesting and a benefit of 1 percent of final average pay for the first 19 years of service; 41 percent of final average pay for the 20th year of service; and 0 percent of final average pay for service after 20 years. It is not clear that accruing this benefit $1/60^{\text{th}}$ for each of the first 19 years and $41/60^{\text{th}}$ for the 20th year is preferable; nor is it clear that accruing the benefit immediately (full vesting) is preferable; nor is it clear that accruing the benefit over the period of anticipated separation from service (which may be beyond 20 years) is preferable.

We suggest that 3.9.1.b.4 be re-written as follows, “The actuary should use professional judgment in applying the following guidelines for determining the amounts of accrued benefit:” and that the (i), (ii) and (iii) be re-written as:

- i. If the plan provisions specify how to calculate an accrued benefit, that specification may be used for the contingencies to which it applies.
 - ii. If the benefit is or may become vested, the benefit may be considered to accrue in proportion to the ratio of completed years of service to projected years of service when it would first become fully vested.
 - iii. The benefit may be assumed to accrue in proportion to the ratio of completed years of service to projected years of service upon anticipated separation from covered employment.
- 3.10.c We suggest the phrase “unless the legislative/regulatory authority restricts such approach” at the end of the second sentence.
- 3.12 The beginning of the third paragraph places a burden on actuaries to craft the terms of the scope of their assignment to exclude this analysis. We suggest that it be rewritten as “To the extent such an evaluation is within the scope of the actuary’s assignment.”
- 3.13 We suggest the first sentence be re-written as:

“The actuary may adjust results from a prior measurement date in lieu of performing a new detailed valuation as of a later measurement date if, in the actuary’s professional judgment, such an adjustment would produce a reasonable result for purposes of the measurement.”

Since the last sentence of this section touches on matters addressed in ASOP 27, the phrase “pursuant to ASOP 27,” should be appended thereto.

- 3.14.c This paragraph appears to place a burden on the actuary to monitor the investment practice of the plan sponsor. We suggest the words “investment practice and” be deleted from the fifth line of the paragraph.

3.16 We suggest the words “use professional judgment to” between the words “should” and “establish” in the first sentence.

“Materiality” has different meanings in different contexts. It is not clear how the actuary should assess that results are or are not “materially different.” We recommend that the following sentence be added after the first sentence of the paragraph: “The actuary should discuss with the principal the level of materiality that the principal and other users of the actuary’s work are anticipating before using a technique that would produce less accuracy than the actuary would normally achieve.”

4.1.m “Significant” has different meanings in different contexts. It is not clear how the actuary should assess the level of the margin for error. We recommend that the following sentence be added after the first sentence of the paragraph: “The actuary should discuss with the principal the level of margin for error that the principal and other users of the actuary’s work are anticipating before using a technique that would produce less accuracy than the actuary would normally achieve.”

4.2 We suggest the word “professional” be inserted between the words “actuary’s” and “judgment” in the second sentence. We also suggest the words “plan sponsor” in the second sentence be changed to “principal” to encompass others who may have engaged the actuary to perform a measurement but who are not necessarily the plan sponsor (such as a potential buyer in a due diligence engagement).

We thank you for this opportunity to share our comments on this exposure draft and appreciate your consideration of the items we have outlined in this letter. Please contact Heather Jerbi, the Academy’s senior pension policy analyst (202.785.7869; Jerbi@actuary.org), if you have any questions or would like to discuss this matter further.

Sincerely,

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