

Comments on the Discussion Draft on Assessment and Disclosure of Risk Associated with Pension Obligations, Plan Costs, and Plan Contributions

October 12, 2012

The Actuarial Standards Board

The American Society of Pension Professionals & Actuaries (ASPPA) and the ASPPA College of Pension Actuaries (ACOPA) appreciate this opportunity to comment on the discussion draft on risk. We ask that our comments be considered although they are being submitted after September 30.

This response to the questions posed in the discussion draft is presented by actuaries who work primarily on small to mid-sized pension plans, including plans in which a significant portion of the pension obligation is attributable to principal employees.

General Comments

ACOPA is concerned that the ASB, through recent proposed revisions to existing standards and this discussion draft, is unilaterally expanding the scope of the typical engagement between plan sponsors and actuaries. The discussion draft would require work that is beyond the economic value that would be provided to principals in many situations, especially in the small pension plan arena. We are also concerned that the result of required disclosure of a wide array of risks could in fact obfuscate the importance of risks that are most critical to the principal. The actuary, in consultation with the principal, should be given broad discretion to ascertain which risks are of most importance to the particular assignment, and focus on assessing those risks.

Comments on the ASB Pension Committee's Questions

Question 1: Do you believe it is appropriate to require the actuary to assess and disclose pension risk for substantially all pension actuarial assignments? If so, do you believe that the approach in this discussion draft is appropriate? If not, what approach do you recommend?

Response: ACOPA agrees actuaries should disclose the nature of risks to principals, but does not believe it is appropriate to require assessment and disclosure of pension risks for substantially all assignments. There are assignments, which may be more prevalent in the small plan market, where disclosing the nature of risk is sufficient, and further assessment is not meaningful. Requiring assessment and disclosure of pension risks would expand the assignments for actuarial work in an environment where principals

would receive no additional benefit, and would not (and should not) appreciate the additional cost.

The proposed standard does not recognize the wide range of education, financial sophistication and appetite for risk in the universe of principals and thus the different needs for assessment and disclosure of risks

- For some plan sponsors the pension plan has a significant impact on the company's financial statements and for some plan sponsors the pension plan is insignificant.
- Some plans sponsors have comprehensive risk management strategies and some do not.
- Public policy may require a higher level of risk assessment and disclosure for public plans and plans sponsored by public companies than private plans.
- In some cases, the assessment and disclosure of risks does not result in meaningful actionable intelligence for the plan sponsor. For example, disclosure of potential risks may be more meaningful when benefit increases are being contemplated than when discussing contribution ranges for a frozen plan.

The actuary and principal are in the best position to determine how much risk should be assessed and disclosed considering the circumstances of the plan and the plan sponsor.

Question 2: Do you believe that the assessment of risk can be achieved solely through a narrative describing the risks or do you believe that some type of quantitative analysis is necessary to assess pension risk?

Response: ACOPA believes that a narrative is often the most appropriate approach. In certain situations, the quantification of risks may mislead rather than inform. Five years ago, no model would have anticipated the economic conditions we face today. If an actuary quantified risks in 2007, the principal would come to the conclusion those projections were meaningless, if not misleading. Furthermore, quantification of risks in an arrangement as volatile as a small defined benefit plan would in almost all situations prove useless to principals.

Question 3: Section 3.2 identifies four specific risks to be assessed. Are these four specific risks the primary risks to assess? If not, what changes do you suggest?

Response: The four specific categories of risk identified in Section 3.2 would include most common risks, however the effort to clearly define categories will lead to confusion unless the actuary is provided with broad discretion in deciding what risks should be assessed and disclosed. For example:

- If a plan's policy is to match assets and liabilities, distinguishing investment risk from asset/liability mismatch risk could be more confusing than helpful.
- Longevity risk may not be relevant to a plan that reasonably expects to pay the vast majority of its benefits as lump sums calculated at assumptions specified in the plan document.
- Interest rate risk may not be relevant to plan sponsors who reasonably take a long-term view of the plan's funded status and are unconcerned with temporary, extreme fluctuations in interest rates.

We note that "other risks", such as changes in the employee population, regulatory changes or legislative changes, can be very significant, and think it would be a disservice to principals if a discussion of critical "other risks" was lost in a mandatory recitation of the specified categories of risk.

ACOPA is also concerned with the definition of risk as relating to "losses or shortfalls". For plans that are frozen, or for plans that soon will be terminated because the principal is nearing retirement age, the risk of over funding and incurring a substantial excise tax is equally important to the principal. The proposed risk structure is overly focused on losses and shortfalls to the plan without considering potential plan overfunding and the potential opportunity costs, losses to shareholders and ongoing company operations that could result from overfunding plans.

Question 4: ASOP No. 4 does not require the actuary to assess sponsor viability. This proposed standard is silent on the question. Should a risk standard specifically require the actuary to evaluate how sponsor viability might negatively impact a plan's financial condition, remain silent on the question (other than the open-ended section 3.2.5 of this discussion draft), or take the approach used for ASOP No. 4? Why?

Response: It would not be appropriate for the risk standard to require evaluation of the impact of sponsor viability on a plan's financial condition. Unless the plan sponsor is publicly held, financial information may not be easily accessible, and even if information is available, the actuary may not be qualified to assess viability of the plan sponsor. Additionally, while the funded status of the plan is an important consideration, in the event that a plan sponsor is no longer viable, the pension plan is just one of hundreds or thousands of issues a plan sponsor must resolve.

Question 5: Would the language in the discussion draft provide sufficient guidance to actuaries performing risk assessment work? If not, what additional guidance should be provided?

Response: The proposed standard requires that actuaries select the assumptions used to assess risk but does not provide sufficient guidance on how actuaries should choose these assumptions.

Question 6: Is the language in the discussion draft sufficiently flexible to allow for new developments in this newer area of actuarial endeavor?

Response: By specifically identifying the risks associated to be evaluated in Section 3.2, the draft does not contemplate an evolving framework for evaluation of pension risks. Additionally, the focus on negative experience does not contemplate changes in economic circumstances where it may be more appropriate to disclose and assess the risks of positive experience.

In summary, ACOPA asks that the next draft provide sufficient flexibility for the actuary to judge what risks merit assessment and disclosure to avoid the volume of disclosure obscuring key concerns. We also ask that the unique nature of smaller pension plans be considered when the exposure draft is developed.

This letter was prepared by the ASOP Task Force of the ACOPA Intersocietal Committee, Richard A. Block, Chair. The primary authors were Richard A. Block, MSPA; Thomas J. Finnegan, MSPA; Robert Mitchell, MSPA; Kurt Piper, MSPA, and Karen Smith, MSPA.

Thank you for your consideration of these comments.

Sincerely,

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