AMERICAN ACADEMY *of* ACTUARIES

October 11, 2011

ASB Comments
Actuarial Standards Board
1850 M Street, NW
Suite 300
Washington, DC 20036

Re: Comments on ASOP 4, *Measuring Pension Obligations and Determining Pension Plan Costs or Contributions*

To Whom It May Concern:

The American Academy of Actuaries[1] Pension Committee is pleased to present the following comments to the Actuarial Standards Board (ASB) regarding ASOP No. 4, *Measuring Pension Obligations and Determining Pension Plan Costs or Contributions*.

In January 2011 the Pension Committee of the ASB issued a Discussion Draft regarding possible revisions to ASOP No. 4. The Discussion Draft included a proposal to define "Market-Consistent Measures" (MCMs) of pension obligations. The proposal established the concept of a "market-consistent actuarial present value" (section 2.12) and then applied that concept to define a specific measurement of a "market-consistent actuarial present value of accrued benefits" (section 2.13).

The Pension Committee of the Academy spent a great deal of time considering this particular aspect of the Discussion Draft. Our recommendation is that the ASB should not define a single MCM for pension obligations and should not require a disclosure of any such obligation. If the ASB wishes to provide guidance in this area, we recommend instead that the ASB identify MCMs as a ***class*** of measurements of pension obligations and provide a discussion of the factors that may be considered in the development of such a measure. This discussion should provide substantial flexibility and should be clear that the factors considered, the assumptions used and the measurement itself can vary substantially based on the purpose of the measurement. We believe that an Academy practice note might be a more appropriate vehicle for advancing practice in this evolving and diverse area.

MCM is a class of measures, not a single measure

The concept of an MCM applies to a variety of specific measures all sharing two common features. First, the discount rate (or rates), as well as other economic assumptions used are based on current market yields, rather than on the expected return on a portfolio of assets dedicated to providing for the pension obligation. Second, the measure of obligation is a simple present value of the pension benefit (typically, but not necessarily, the benefit accrued to date), rather than a measure based on

[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.

some allocation of projected pension benefits (such as the level cost allocation under the Entry Age Normal cost method).

Within this class of MCMs, specific choices of the valuation parameters (discount rate, accrued benefit measure and other assumptions) will depend primarily on the purpose of the measurement. Such purposes could include measurement of termination or withdrawal liabilities, defeasement costs, or values appropriate for financial economic modeling. Another reason that the valuation parameters – particularly the discount rate – could vary is the existence or availability of actual or proxy "markets" for settling or otherwise serving as the basis for the market-consistent valuation of the pension obligation.

The position that MCMs are a class of purpose-specific measures rather than a single measure is supported by the fact that there are and have been several specific MCMs defined by different regulatory agencies for different purposes. Some of the more common MCMs are:

- PBGC present value of vested benefits
- IRC Sec. 414(l) current liability
- IRC Sec. 430 funding target
- FASB ASC Topic 715 accumulated and projected benefit obligations

Reasons that the ASB should not define a *single* MCM

Because MCMs are really a class of measures, defining a single MCM independent of any identified purpose is inconsistent with the fact that MCMs, like all actuarial measurements, are purpose-specific. Creation of a single, purpose-independent MCM would be misleading and confusing to the users of actuarial information by conveying that there is a single, universally applicable form of MCM when in fact the selection of an MCM should always be purpose-specific.

The scope of applicability of an actuarial standard with respect to an MCM is inextricably linked to the purpose of the MCM. An MCM developed for a particular purpose may not be applicable to plans where that purpose is not a consideration. Defining a single, purpose-independent MCM applicable to all plans in all situations could end up artificially imposing a measure in many situations for which the MCM is not relevant.

Another related consideration is that defining a single MCM could misrepresent and overstate the degree of comparability among plans that are different in nature and circumstance (e.g., corporate, multiemployer and public plans) by giving the impression that a single measure of MCM provides comparable information for all pension plans.

One additional reason that the ASB should not define a single MCM is that, as discussed above, several purpose-specific versions of MCMs are already defined and mandated for ERISA funding, benefit restrictions, multiemployer disclosure, PBGC premiums, as well as for financial disclosures. It would be unproductive and confusing for the ASB to define another, competing MCM especially if, unlike these other existing MCMs, the purpose of the ASB's new MCM is not specified.

In summary, by defining a single MCM, the ASB would in effect provide tacit endorsement of a single, universally applicable measure of pension obligations. This is inconsistent with the purpose-specific character of MCMs as a class of measures and impractical in terms of the obligations it imposes on the actuary relative to the needs of the Principal. While the disclosure of the MCM might not technically be required, it is easy to envision it becoming a *de facto* requirement – either via wide-spread requests for the measure from third parties, or as a result of the apparent intention of the ASB to at least consider a disclosure mandate for MCMs.

Instead of defining a single, new MCM, the ASB could use the revision of ASOP 4 to provide guidance to the actuary about what to consider when developing an MCM appropriate for a given situation or, as suggested above, provide a framework for a more expansive discussion of the topic to be addressed in a practice note.

Issues the ASB must resolve or address if a single MCM is defined

Should the ASB choose to move ahead and define a single MCM, there are many issues that it will need to address. We summarize some of these issues below, but note that any detailed discussion of these issues illustrates the fundamental point that MCMs must be purpose-specific and that it is inadvisable to define a single-purpose, independent MCM.

First, the ASB must resolve the underlying purpose of this new MCM, because an MCM cannot be developed independent of some predefined context. Based on the defined purpose, it might be appropriate to select an MCM from among the existing MCMs noted above or perhaps to define a new MCM based on certain elements of one or more of these measures. The ASB must also distinguish and differentiate the new MCM from the previously existing MCMs. It will be crucial to minimize confusion and misunderstanding by the ultimate users of the new measure.

Another important issue that is difficult to resolve in a uniform fashion is the selection of the discount rate, including the issue raised in the Discussion Draft of "whether to factor the credit worthiness of the benefit promise into the discount rate." We believe this refers to the risk or probability of whether the benefit will actually be paid to the plan participant. The selection of this type of risk-adjusted rate would require a clear understanding and communication that the risk measured is not the investment return risk on plan assets (or the related contribution risk for the plan sponsor) but rather the default risk that the benefits will not be paid.

This risk of non-payment is affected by many factors that vary according to the type of pension plan. As examples, for corporate plans risk factors include the level of PBGC benefit guarantees and the continued existence of the corporate plan sponsor, while for governmental plans the risk factors include whether there is a legally enforceable contribution demand on the governmental plan sponsor. The perspective of the user would generally determine which of these risk factors are relevant (and which MCM is desirable) in a particular situation.

In particular, the credit worthiness of the benefit promise is distinct from the credit worthiness of the plan sponsor. While there would seem to be some relationship between the two, the conclusion that the MCM-based value of the pension promise made by a financially weak sponsor is lower (via a higher, more risky discount rate – because the sponsor might not be able to deliver on that promise) may not be tenable and at best could invite misinterpretation and confusion.

The ASB would also need to address numerous technical issues for the new MCM, including whether to reflect future salary increases – or benefit increases (such as cost-of-living adjustments) – in this measure, how to accrue benefits that do not accrue in proportion to service, and how much latitude the actuary and Principal would have in selecting demographic and economic assumptions beyond the discount rate.

We raise these issues here not to try to resolve them, but to illustrate the difficulties associated with attempting to define a universally applicable MCM. Existing MCMs are defined in a particular context, often with extensive guidance relating to the calculation of the measure. Attempting to create a new MCM would be a significant undertaking, requiring the production of similar volumes of guidance. This further supports our recommendation that the ASB should not define a single MCM for pension obligations, but should instead identify MCMs as a class of measurements of pension obligations and provide guidance on the development of such a measure based on the purpose of the measurement.

Thank you for consideration of these comments. The Pension Committee plans to send additional comments to you on the following issues:

- Whether the expanded cost/contribution allocation definitions and disclosures are clear, sufficient, and appropriate.
- Whether the revised "prescribed assumptions/methods" definitions are clear, sufficient, and appropriate.
- Advocating guidance on the selection and evaluation of an amortization method (just as for actuarial cost methods in section 3.11). In particular, ASOP No. 4 should provide guidance regarding certain characteristics of an amortization method that should be disclosed.

If you have any questions or require further information, please contact Jessica Thomas, senior pension policy analyst (Thomas@actuary.org; 202/223-8196).

Sincerely,

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Chairperson, Pension Committee
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