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ASOP No. 4 Revision (Second Exposure Draft)
Actuarial Standards Board
1850 M Street, NW, Suite 300
Washington, DC 20036

Re: Comments on ASOP4 - Second Exposure Draft

Dear ASB Members:

First, thank you for the opportunity to comment on the Second Exposure Draft for *Proposed Revision to Actuarial Standard of Practice (ASOP) No. 4* ("ASOP4"). The comments herein are my own alone, and incorporate and reiterate some prior observations.

Second, I commend the Pension Committee for making significant improvements to the First Exposure Draft. In particular, I commend the Pension Committee for its steadfastness in retaining some semblance of Section 3.11 in this version of the proposed ASOP4.

Third, that said, the proposed revisions to Section 3.11 appear to have moved the proposed ASOP4 further away from requiring the disclosure of a *Solvency Liability* as would be defined by financial economists.

On the good side, with respect to terminology, the term *Low-Default-Risk Obligation Measure ("LDROM")* is a significant improvement over the term *Investment Risk Defeasement Measure*. Consistent with financial economics theory, I still would prefer to see the proposed ASOP4 require and present a true *Solvency Liability* and that it be referred to as such or as something more like what is intended. Possible terminology could include a *Liability Defeasement Measure ("LDM")*, or as I suggested previously, a *Secured Accrued Benefit Liability ("SABL"),* a *Guaranteed Accrued Benefit Liability ("GABL"),* a *Defined Accrued Benefit Liability ("DABL"),* a *Promised Accrued Benefit Measure ("PABM")* or something similar.

On the other hand, the choice of terminology I propose presumes that the *LDROM* would be defined as a *Solvency Liability*, meaning it represents the economic value of benefits accrued to the date of measurement, assuming they are sure to be paid (e.g. benefits earned to date under the *Accrued Benefit Obligation ("ABO")* measure, discounted at U.S. Treasury yields).

What appears to be permissible for an *LDROM*, as an example and as I understand it, and what would NOT fit with financial economics principles, could taking projected benefits developed under a cost-allocated Entry Age Actuarial Accrued Liability method and discounting them at something other than U.S. Treasury yields.

Again, I encourage the Pension Committee and the entire Actuarial Standards Board to require that the calculation of the proposed *LDROM* be a *Solvency Liability* measure that would align it more closely with financial economics principles.

Fourth, following is a repeat/embellishment of some earlier remarks for consideration:

1. Use of ASOPs: ASOPs are presented often as representing swords and shields to help actuaries produce better work and then defend it. However, at least for Public Pension Plans and Multiemployer Plans, much actuarial work is performed for agents (e.g. intermediaries such as Boards of Trustees, Plan Administrators, labor representatives, Plan Sponsor representatives, etc.) who are not the ultimate bearers of the economic impact of their decisions (e.g. taxpayers, primarily future taxpayers and, alas, when things go badly, Plan participants whose benefits get cut).

   It is often the actuaries who are expected to defend Pension Plan funding. Without strong professional requirements on the actuaries, it is extremely easy for those actuaries to defer when pressured by agents, ALL of whom seem to prefer lesser funding now. Alas, I am concerned that even where actuaries protest that they are not succumbing to pressure, most might admit that they are often utilizing the upper end of their "reasonableness" ranges.

2. Actuarial Responsibilities and Risks: As noted, actuaries are often not the decision makers on the actuarial assumptions and methods employed to determine financial commitments to many Public and Multiemployer Pension Plans. In these cases, actuaries may, nevertheless, be perceived by the public as responsible (i.e. the actuaries are the experts) and subject to ridicule if they try to hide behind the "it was not my decision" defense when things go wrong. This suggests that having strong actuarial standards is important to protect, not just the actuaries, but Plan participants, the public and everyone else involved with Pension Plan financing.

   Pension actuaries have excellent budgeting models but generally do not embrace discussing or disclosing the financial economics of defined benefit pension plans, putting the entire actuarial profession at risk. The actuarial profession has a modest number of members and its entirety could suffer reputational risk should the day come when some Public Pension Plans and/or their Plan Sponsors become financially stressed and Public Pension Plan actuaries have not presented the economic value of Plan benefit promises.

3. Amortization Methods: Prescribing amortization methods and periods should not be necessary, but actuaries should be required to evaluate and comment upon the implications of whatever amortization methods and periods are used (negative amortization, in particular).

For example, many Public Pension Plan actuaries are comfortable with long-period, payroll-related, increasing-dollar amortization of any Unfunded Actuarial Accrued Liability ("UAAL"). In some cases, these UAAL amortization schedules may clearly be inconsistent with the demographics of the Plan Sponsor (e.g. Detroit). Consequently, it may make sense to require the presentation of contributions based on some philosophically based, often more conservative, amortization schedules.

If Intergenerational Equity suggests that financing retirement benefits should occur over the working lifetimes of employees, this might be a useful benchmark for developing a comparable UAAL amortization schedule (i.e. amortization over the remaining working lifetimes of active employees). Actuaries should then speak to this and to the implications of Plan Sponsors choosing alternatives to this funding on this schedule when Unfunded Actuarial Accrued Liabilities exist.

4. Actuarial Assumptions: Specific guidance should not be necessary. That said, I agree with the proposed requirement that an actuary should evaluate and comment on the appropriateness of the actuarial assumptions being used. I further believe that an actuary should do such an evaluation and make such comments, whether the actuary establishes the assumptions or not.

   If I understand it correctly, the Second Exposure Draft appears to clarify that actuaries must disclose where there should be concerns about the overall financing of a Plan.

5. Alternative Liability Measures: While much should be left to professional judgment, it would benefit actuaries, their clients and the public to see the disclosure of a market-consistent determination of the value of benefits earned to date, sometimes referred to as a *Market Value Liability ("MVL")*. In my work, I have often referred to this type of calculation as a *Market Value Accumulated Benefit Obligation ("MVABO"*). For most Public Pension Plans, where the risk of benefit default is minimal, the *MVABO* is virtually identical to the *Solvency Liability* (i.e. this term was defined in the 2006 *Pension Actuary's Guide to Financial Economics*) and, in the United States, can be determined by discounting using U.S. Treasury Spot Yields a projected stream of ABO-determined accrued benefits.

   Going forward, I believe that all pension actuaries should be disclosing a *Solvency Liability* whenever they provide information on Pension Plan financing. In this Second Exposure Draft, the Pension Committee has improved on the name it wishes to use. The term *Low-Default-Risk Obligation Measure* is a better term as the prior term (i.e. *Investment Risk Defeasement Measure*) was too limiting. However, as defined, the *LDROM* is still not required to be a true *Solvency Liability* measure. While the Pension Committee has recognized that the proposed *LDROM* has uses beyond just investment risk analysis, disclosing a *Solvency Liability*, a measure of the economic value of promised benefits, would be much better and is something of which all Stakeholders should be aware.

Further, having actuaries provide *Solvency Liability* information would mean that the information is more accurate than that produced by non-actuaries. It would also demonstrate that actuaries understand the economics of defined benefit pension plans and that actuaries are not just providers of budgeting models.

In case of concern about misuse or negative connotations, please note that the *MVABO* measure (calculated as equal to the *Solvency Liability*) was presented annually from June 30, 2003 to June 30, 2014 in the Comprehensive Annual Financial Report ("CAFR") of each of the New York City Retirement Systems ("NYCRS"). While the press would occasionally utilize the *MVABO* to highlight the significant economic value of defined benefits and question whether they were too expensive, the world did not end, nor did the City of New York end, just because these numbers were published.

6. Projected Benefit Streams: In addition to providing a *Solvency Liability* measure, it would also be worthwhile if actuaries were encouraged (required) to disclose a projection of the accrued benefits.

   This is particularly important if the ASB should decide against requiring the disclosure of a *Solvency Liability*. There are multiple other users of Pension Plan financial information who, if not provided with a *Solvency Liability* measure and/or some other economically realistic measure of pension obligations, try to develop their own.

   As the economic value of a stream of pension benefits is NOT dependent upon what assets are used to finance them, the disclosure of a projection of accrued benefits would, at least, provide the building blocks that economists and other financial users are seeking and allow them to make better estimates.

7. Economic Normal Cost: It would also be useful require disclosure of an economic Normal Cost (i.e. the expected increase in *Solvency Liability* for the next year).

8. ASOP27 and ASOP35: To the extent any of the comments herein on the ASOP4 Exposure Draft should be applicable to the ASOP27 and/or ASOP35 Exposure Drafts, please consider them therewith.

Finally, thank you again for the opportunity to comment and for your consideration.

Yours truly,

Robert C. North, Jr.