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ASOP No. 4 Revision
Actuarial Standards Board
1850 M Street, Suite 300
Washington, DC 20036

July 30, 2018

Subject: Proposed Revision of Actuarial Standard of Practice (ASOP) No. 4

I would like to thank the Actuarial Standards Board (ASB) for the opportunity to provide comments on the proposed revision of ASOP No. 4. These brief comments largely focus on section 3.11 "Investment Risk Defeasement Measure" and certain semantic issues. The primary reason for this brevity is that most of my comments on the previous revision of ASOP No. 4 are still valid. I would like the ASB to consider these comments for this revision as well.

Section 3.11 "Investment Risk Defeasement Measure" contains the most consequential changes to the proposed standard. This section explicitly introduces the concept "*a hypothetical bond portfolio whose cash flows reasonably match the pattern of benefits expected to be paid in the future*." I consider the introduction of this concept a major step in the right direction, even though the concept has substantial room for improvement.

By virtue of utilizing "hypothetical bond portfolios," this ASOP ventures into the area of portfolio selection; by virtue of calling section 3.11 "Investment Risk Defeasement Measure," this ASOP ventures into the area of risk management. The former should be encouraged; the latter should be avoided.

Perfectly matching bond portfolios do not exist for most plans. It is true that the market price of a hypothetical matching bond portfolio may be informative in some cases. Still, requiring actuaries to express opinions on the risk-mitigating properties of these portfolios may not be a good idea. Real life investable bond portfolios may or may not reduce the riskiness of pension plans. Section 3.11 should be entitled "Market Values of Relevant Buy-and-Hold Assets" or something close to it. "Risk defeasement measures" do not belong to this ASOP.

Furthermore, "hypothetical bond portfolios" do not have to match *all* the "benefits expected to be paid in the future." For example, it may be valuable to estimate the market value of a bond portfolio that matches the benefits for a sub-group of plan participants (e.g. retirees and beneficiaries) or even first *N* years of these benefits. As another example, it may also be valuable to estimate the market value of a bond portfolio that matches the excess of benefits over expected contributions in the next *N* years.

Thus, there is no need to require "hypothetical bond portfolios" to "reasonably match" benefits – these portfolios may be useful even if they only offset some benefits. The standard should recognize that there may a multitude of "buy-and-hold" assets relevant to retirement plans – matching and non-matching. Actuaries should have wide latitude to utilize reasonable methods to estimate the market values of these assets.

The presence of hypothetical matching bond portfolios makes "market-consistent present values" obsolete. The concept of "market-consistent present values" is neither useful nor necessary. The term "market-consistent present value" should be replaced by "the market value of the hypothetical matching bond portfolio" throughout this ASOP.

To recap, I propose the following changes:

1. Section 3.11 should be entitled "Market Values of Relevant Buy-and-Hold Assets" instead of "Investment Risk Defeasement Measure,"
2. The term "investment risk defeasement measure" should be eliminated.
3. In section 3.11, the phrase "the actuary *should* calculate" should be replaced by "the actuary *may* calculate."
4. Section 3.11 should state that the actuary may estimate and disclose the market value of any "buy-and-hold" asset that may be relevant and beneficial to the plan. Such "buy-and-hold" assets include but are not limited to hypothetical matching bond portfolios.
5. If "a hypothetical bond portfolio whose cash flows reasonably match the pattern of benefits expected to be paid in the future" is deemed relevant to the plan, then the actuary should estimate and disclose its market value.
6. The term "market-consistent present value" should be replaced by "the market value of the hypothetical matching bond portfolio."

Let us address certain semantic issues related to this standard. The exposure draft of the January 2012 revision of ASOP No. 4 contains the following remarkable statement:

> "*The word "liability" has created challenges for actuarial communications for decades and continues to do so today*."

While this statement is undeniably true, it does not go far enough. The terminology currently used by the pension actuarial community has created challenges for actuarial communications for decades and continues to do so today. I would like to encourage the ASB to consider the following suggestions:

1. Cash flows and their present values should have different terms. In general, I propose to use the term "commitment" for cash flows and the term "required assets" for present values.
2. The term "liability" should be avoided whenever possible. In many cases, the term "required assets" would be more appropriate.
3. The term "obligation" should be used only for the purposes statements of the Financial Accounting Standards Board (e.g. projected benefit obligations, accumulated benefit obligations).
4. The term "retirement commitments" should represent payments to retirement plan participants and beneficiaries (commitments out-flows) and plan sponsor's contributions to retirement plans (commitments in-flows). ASOP No. 4 should be called "Measuring Retirement Commitments." The present value of future benefits (PVFB) would be an example of a commitments out-flow measurement. The present value of future normal costs (PVFNC) would be an example of a commitments in-flow measurement.

In recent years, the ASB has occasionally proposed and adopted short-term temporary fixes to emerging fundamental problems. The current revision contains certain reflections of this unfortunate trend. I would like to urge the ASB to embrace long-term solutions and reconnect the standard to the key principles of actuarial science and finance in general.

Thank you for your attention to these comments. Feel free to contact me if you have any questions/comments. I would be happy to assist the ASB in the development of this standard and related issues.

Sincerely

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