Bolton
Employee Benefits, Actuarial & Investment Consulting

July 29, 2020

ASB Comments
American Academy of Actuaries
1850 M Street, NW, Suite 399
Washington, DC 20036
Via email: comments@actuary.org

Re: Comments on Second Exposure Draft of ASOP 4

Members of the Actuarial Standards Board:

This letter documents the comments submitted for consideration on behalf of Bolton with respect to the second exposure draft of Actuarial Standards of Practice No. 4, *Measuring Pension Obligations and Determining Pension Plan Costs or Contributions*.

Bolton is an employee benefits consulting firm serving a national client base with clients in the governmental, single employer and multiemployer sectors. Our clients include sponsors of for-profit and non-profit pension plans, for which the work we provide is subject to the requirements of ASOP 4. We also provide services to a variety of other employee benefit plans, including Length of Service Award Programs (LOSAP) and other postretirement benefit (OPEB) plans. We provide actuarial services for approximately 150 defined benefit and LOSAP plans. Our firm employs 115 professionals, including 26 credentialed actuaries.

We appreciate the ASB's extension of the comment deadline to allow actuarial consultants such as ourselves additional time to prepare thoughtful remarks while balancing the increased demand on our time over the recent months. The signers of this letter have had the opportunity to provide input to comment letters being prepared by various actuarial groups, including the Pension Committee of the American Academy of Actuaries and the Conference of Consulting Actuaries Public Plan Community. As such, we are allowing those letters to speak to many of the comments we would otherwise submit for consideration and are limiting our comments to one specific aspect of the second exposure draft that we would like to emphasize to the ASB.

Specific Comments

Section 3.11 of the second exposure draft discusses the disclosure of a "low-default-risk obligation measure". Our comments focus on the application of this requirement to plan designs that share all or a portion of investment return experience with plan participants.

Valuing the expected benefits at proposed bond rates provides a Low-Default-Risk Measure that has no meaning for certain plan designs. The draft ASOP appears to attempt to remedy this by giving the actuary the flexibility to adjust "for variations in benefits earned as of the measurement date". While the second to last paragraph in Section 3.11 allows the actuary to "reflect the impact" of such variations, the last paragraph in Section 3.11 makes it clear that this flexibility does not extend to the discount rate assumption.

When plan benefits vary based on investment returns or changes in an external market index, it is not enough to give the actuary the flexibility to adjust the benefit payment projection while continuing to require use of a bond-based discount rate. Flexibility in selecting an appropriate discount rate is also needed. For a variable annuity plan, this would most likely mean the actuary values the projected benefit payments using the hurdle rate. While our comments focus on variable annuity plans, similar issues arise in dealing with gain sharing plans and market-based cash balance plans.

Some actuaries may value future benefits for a variable annuity plan under the low-default-risk obligation measure to be decreasing over time. If the assets are not invested in a bond portfolio, we argue this would not be the actuary's best estimate of future benefit payments. However, without such an adjustment to future benefit payments the net result is an overstated liability which provides no meaningful information to the users of the valuation. Conversely using a low default discount rate while assuming increasing benefits in accordance with the plan's investment allocation results in unreasonable assumptions in the aggregate. Under either approach, the actuary will be forced to make an unreasonable assumption. To avoid this dilemma, the actuary needs flexibility to adjust the discount rate for these types of plans.

Where such a plan has a cap and/or floor on the variable adjustment, the actuary should adjust for the value of these embedded features to ensure the present value produces a low-default-risk measure that is consistent with the intended disclosure. (We note that **Section 3.5.3** discusses these sorts of provisions and identifies some techniques that actuaries may employ to make such an adjustment.)

Recommendations

Determining an appropriate low-default-risk measure for variable annuity plans (and others with similar risk-sharing features) will require the use of professional judgment, as the range of potential scenarios is too expansive to allow for a prescriptive definition that is universally appropriate. We recommend that the ASB include such flexibility in the final standard.

To achieve this flexibility, we recommend adding the following language to the end of the last paragraph in **Section 3.11**:

> ***If plan benefits depend on investment returns and investment risk is borne by plan participants, the use of reasonable assumptions will include adjustments to the low-default-risk discount rate and other appropriate assumptions that reflect the risk borne by the plan and which properly reflect the security of participant benefits that are tied to investment return.***

The language we propose would allow the actuary to provide a meaningful number while still meeting the intent of the stated standard. Absent such flexibility to use professional judgment, actuaries may be left with two unappealing and undesirable options:

1. employ the deviation provision in Section 4.3(b) of the standard (to allow for determining a low-default-risk measure that does not meet with the requirements of Section 3.11), or
2. determine a low-default-risk measure in accordance with Section 3.11 and disclose that they believe this is an inappropriate measurement, and the reasons for such belief.

Thank you for this opportunity to comment on the second exposure draft. If you have any questions concerning our comments, please reach out to either of us directly.
Sincerely,

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