Willis Towers Watson

July 1, 2020

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

Dear Sir or Madam:

This letter documents the response of Willis Towers Watson to the proposed revision of Actuarial Standard of Practice ("ASOP") No. 4 Measuring Pension Obligations and Determining Pension Plan Costs and Contributions, as requested in the Second Exposure Draft (ED) dated December 2019.

Willis Towers Watson is a leading global professional services company that employs over 40,000 associates worldwide, over 1,100 of whom are members of U.S. actuarial bodies subject to the standards and approximately 600 of whom are enrolled actuaries. We provide actuarial and consulting services to more than 1,700 defined benefit plans in the U.S. The undersigned have prepared our company's response with input from others in the company.

Our overarching comment is that many pension plans, such as qualified U.S. plans in the private sector, are already subject to a vast array of rules and requirements. The standard proposed by the Exposure Draft would introduce redundant analyses and disclosures for these plans. It would be more appropriate to provide exemptions for plans already subject to such governance. In this way, the ASOP would benefit those actuaries operating in areas without clear guidance, but it would not make others bear the burden of superfluous requirements.

We appreciate the opportunity to provide the following comments, which we have organized sequentially by section. To make our comments as clear as possible, we have bolded terms that are defined and bolded within the ASOP.

Specific Comments

Section 2.7 Definition of Amortization Method – We note that the term "unfunded **actuarial accrued liability**" makes sense for an **amortization method** used for a **funding valuation** (i.e., used in a **contribution allocation procedure**). It does not make sense for an accounting valuation (i.e., when used in a **cost allocation procedure**), since unamortized amounts in that case are those that have not yet been reflected in accounting costs, not that have not yet been funded.

Sections 2.8 Contribution Allocation Procedure and 2.9 Cost Allocation Procedure - Both the prescribed calculations for minimum required contributions of a qualified pension plan, and the ASC 715 and ASC 960 accounting results, are methods that are prescribed, and applying those prescribed methods does not require or permit consideration of some of the items required to be considered by Section 3.17 for **contribution allocation procedures** and **cost allocation procedures** (e.g., "intergenerational equity", "relevant input from the principal" or "the nature and frequency of plan amendments"), The standard should be clear that the terms **cost allocation procedure** and **contribution allocation procedure** do not apply to prescribed methods.

Willis Towers Watson
3001 Summer Street
Stamford, CT 06905

willistowerswatson.com

Section 2.18 Definition of Output Smoothing Method – It would be helpful if the ASOP would specifically indicate that an asset valuation method is not treated as an **output smoothing method**, as it appears to meet the definition (it is "a method to reduce volatility" and "a component of the **contribution allocation procedure**"). It seems that it is not intended to be included within the definition (e.g., in Sections 3.1 and 3.2 **output smoothing methods** and asset valuation methods are separately referred to), but we believe it is important to say this explicitly in Section 2.18.

Section 3.3.2 Uncertainty or Risk – This section requires that "In conjunction with the related guidance in ASOP No. 41, *Actuarial Communications*, and ASOP No. 51, *Assessment and Disclosure of Risk Associated with Measuring Pension Obligations and Determining Pension Plan Contributions*, the actuary should consider the uncertainty or risk inherent in the measurement assumptions and methods and how the actuary's measurement treats such uncertainty or risk".

This does not directly require the actuary to do anything but think about risk when setting assumptions, which is already well covered in Section 3.2 of both ASOP No. 27 and ASOP No. 35.

The reference to ASOP No. 51 is unnecessary and could be misunderstood, as ASOP No. 51 relates to funding pension plans and does not apply to many of measurements to which ASOP No. 4 might apply (most prominently, measurements for accounting purposes).

The reference to ASOP No. 41 is similarly unnecessary and confusing because ASOP No. 41 simply provides (in Section 3.4.1) that "The actuary should consider what cautions regarding possible uncertainty or risk in any results should be included in the actuarial report", which is nothing more than a disclosure requirement, while Section 3.3.2 of this ASOP relates to considerations while setting an assumption.

We believe it is unnecessary to refer to requirements of other ASOPs, especially in a manner that may generate confusion about what is required. We recommend that this section be deleted.

Section 3.5.1 Adopted Changes in Plan Provisions – This section provides that "unless contrary to applicable law, the actuary should reflect **plan provisions** adopted on or before the measurement date". This statement is too prescriptive, as accounting policies or other applicable guidance may also dictate what plan provisions are or are not to be reflected in a measurement (particularly in cases where plan amendments have been adopted but are not yet effective). We suggest that the first sentence of this section be replaced with "Unless contrary to applicable law (e.g., statutes, regulations, accounting standards or guidance, and other binding authority), or not appropriate for the purpose of the measurement, the actuary should reflect plan provisions adopted on or before the measurement date for at least the portion of the period during which those provisions are in effect."

Section 3.6.1 Participants – We believe that the reference to "employees who might become **participants** in the future" should be clarified to read "employees or expected future employees who might become **participants** in the future" to accommodate open group valuations.

Section 3.8 (Actuarial Assumptions) – The section reads "the actuary should assess whether the combined effect of assumptions. . . . . is expected to have no significant bias…except when provisions for adverse deviation are included". However, in some situations such guidance would not be appropriate. For example, an actuary might calculate funding or funded status projections that might use optimistic assumptions (such as showing properly labelled 75th percentile results). Such analysis is a typical part of funding projections and should not represent a deviation from the requirements of ASOP No. 4. We suggest clarifying that the section does not apply if such bias is intended and disclosed.

In addition, our comments on Section 3.25 below, as they relate to the exclusion of the phrase "without performing a substantial amount of additional work beyond the scope of the assignment", also apply to this section – we believe the phrase should read "unable to assess for reasonableness without performing a substantial amount of additional work beyond the scope of the assignment".

Section 3.9 – Measuring the Value of Accrued or Vested Benefits – We recommend Section 3.9(g)(3) (expenses associated with a potential plan termination, including transaction costs to liquidate plan assets) and (4) (changes in investment policy) be deleted or changed. While these costs and investment policy changes are important to consider when advising a Principal on whether assets are sufficient to facilitate a special event, and on plan costs/necessary contributions in the interim, they are typically not included in measuring the value of accrued or vested benefits "reflecting the impact of a special event (such as a plant shutdown or plan termination)". While expenses incurred by an insurance company would typically be reflected in an assumed annuity purchase price, much of the liability for a plan termination may be settled via lump sums, and for a plant closing annuities would typically not be purchased. Other expenses associated with the event would typically not be included in a measure of accrued or vested benefits. These considerations would seem to belong in Section 3.3 rather than in a discussion of determining the present value of vested or accrued benefits.

Section 3.10 – Market Consistent Present Values – We suggest that this section (and the associated definition in 2.15) be eliminated. We do not understand why, in a standard that requires the calculation and disclosure of a low-default-risk obligation measure, and indicates how it should be calculated, this discussion of a **market consistent present value** needs to be included. This measure is not needed. In addition, we note that although the standard does not say this measure has to be included, it does say that if it is included then it must be calculated in a certain way. An actuary who is not required by an authority other than this ASOP to include a measure that meets the definition of a **market consistent present value** is unlikely to include that measure in addition to the **low-default-risk obligation measure** this ASOP separately requires, and an actuary who is bound by a separate authority to provide a measure that meets the definition of a **market consistent present value** already has requirements to follow that will likely conflict with this ASOP.

If the concept is retained it should be made clear that ABO and PBO under ASC 715 are not treated as **market consistent present values**. PBO includes future pay increases not yet earned and neither obligation may "consider how benefit payment default risk or the financial health of the plan sponsor affects the calculation". In fact, any liability (including the funding target used in determining minimum required contributions for qualified pension plans) calculated in accordance with "applicable law (statutes, regulations, accounting standards or guidance, and other binding authority)" should be excluded from the definition of **market consistent present value,** as the appropriate assumptions to use and benefits to reflect would be dictated by those standards.

Sections 3.11 and 4.1(o) Low-Default-Risk Obligation Measure - We ask that the standard specifically state that the **funding valuation** report can refer to other measures already provided to the client (typically ASC 715 results, that are often at the same measurement date, are based on high quality corporate bonds with cash flows that match the plan's expected cash flows, and are delivered much earlier) to satisfy this requirement.

We also note that the definition of **funding valuation** includes any "measurement of obligations or projection of cash flows performed by the actuary intended to be used by the principal to determine plan contributions". This means that this alternative measure is not simply required to be provided once a year when an "official funding valuation" for a year is completed, but would presumably have to be provided whenever any work product is delivered that a plan sponsor is expected to take into consideration in determining how much to contribute (for example, an estimate of contributions needed to avoid benefit restrictions or reporting to PBGC, or to permit an amendment to take effect under IRC §436). We believe this would create substantial amounts of additional work that is largely duplicative and would add little or no value to the Principal. We recommend that this requirement be specifically limited to the annual formal determination of required contributions.

In addition, we strongly object to the requirement in Section 4.1(o)(1) that the rationale for the selection of the discount rate be disclosed. For many pension plans, there are already one or more low default risk obligation measures required to be calculated and disclosed. If our suggestion above (that the actuary simply be able to refer to a measure that meets the definition and already exists for another purpose) is adopted, the rationale for the discount rate is simply to comply with the requirements that apply to such measure. If this measure is being provided only because this ASOP requires it, we note that this ASOP (appropriately) allows a wide range of discount rates to be used,

with the only requirement being that the cash flows underlying the high quality fixed income securities be "reasonably consistent with the pattern on benefits expected to be paid in the future", and provides no guidance on considerations as to which discount rate to select. Because in that circumstance this measure is being provided for the purpose of satisfying this ASOP, and not because the Principal typically will use the measure, the "rationale" for a specific choice will typically be that it is readily available and satisfies the ASOP. Requiring disclosure of the rationale for the choice of discount rate suggests that the actuary must consider other factors in picking the discount rate.

We also note that "benefits earned as of the measurement date" is ambiguous, as the dollar amount of benefits earned may be known but eligibility for subsidies and supplements may depend on future service or the occurrence of a specific event. There should be an affirmative statement that approaches to determining "benefits earned as of the measurement date" should be appropriate for the purpose of the measurement.

Section 3.19 Implications of Contribution Allocation Procedure or Funding Policy — For qualified pension plans, this section is unclear. Funding interest rates are currently stabilized (i.e., higher than current market rates) and, under current law, that stabilization will phase out over coming years, leading to lower interest rates used to determine minimum required contributions. The section indicates that "the actuary may presume that all actuarial assumptions will be realized", which is not the same thing as assuming all actuarial assumptions will remain unchanged. Thus this section is unclear whether the requirement to "estimate the period over which the unfunded actuarial liability is expected to be fully amortized" requires the actuary to model the effect of the phase-out of interest rate stabilization (presumably assuming current market rates remain unchanged) to determine when the unfunded actuarial liability will be fully amortized. Whether actuarial assumptions are assumed to remain the same should be clarified.

Section 3.21 Reasonable Actuarially Determined Contributions - The applicability of this section is unclear. We ask that the ASOP specifically indicate that it does not apply to required funding valuations for qualified pension plans because the minimum funding requirement is based on a **contribution allocation procedure** specified by law and must reflect prescribed interest rates and mortality assumptions and the actuary's best estimates for other assumptions.

Section 3.24 Volatility – We believe that directing the actuary to ASOP No. 51 for guidance in a section that includes **periodic costs**, when ASOP 51 does not apply when determining **periodic costs**, is inappropriate and confusing. The language should be modified to clarify that ASOP No. 51 guidance should be considered only when ASOP No. 51 applies, or deleted since it is not necessary to point out that ASOP No. 51 exists and may apply to a particular actuarial service.

Section 3.25 Assessment of Assumptions and Methods Not Selected by the Actuary - This section replaces section 3.17 (Evaluation of Assumptions and Methods). Although the organization of the sections is different, the requirements are essentially the same with one critical difference. Section 3.17 allowed the actuary not to assess an assumption for reasonableness, and simply to disclose, if "the actuary is unable to evaluate a **prescribed assumption or method set by another party** without performing a substantial amount of additional work beyond the scope of the assignment". The new requirement is that an actuary must assess an assumption unless the actuary "is unable to assess for reasonableness". This is a large difference between these two standards. It may be technically possible for an actuary to be **able** to assess an assumption, and so the actuary is not "unable to", but not without a very large investment of time, collection of information and perhaps additional training.

The most common example of this is the expected return on assets (EROA) assumption for ASC 715 accounting valuations of pension plans. Note that this is not strictly speaking an "actuarial assumption" used to measure plan liabilities or the cost of benefits accruing during the year. Rather, it is simply a credit that appears in the calculation of net benefit cost and is very simply an assumed rate of return on assets multiplied by beginning of year assets. There is no need for an actuary to perform this calculation; however, since net periodic benefit cost is generally shown by component and in total the actuary will generally include this component in the results provided to the client.

ASC 715 vests the plan sponsor with the responsibility for choosing accounting assumptions, and the EROA assumption is most often chosen by the plan sponsor, often with input from the plan's internal or external investment advisors, and very often with little to no input from the actuary. There are many cases where the actuary is unable to assess the reasonableness of the assumption under the circumstances (e.g., due to the scope of the assignment, lack of information, lack of expertise) but could in theory do so given enough time, information, training or consultation with experts, etc. In many cases, the plan assets may include alternative investments, the assumption may reflect elements related to active management premium or rebalancing effects, etc. and a large amount of information might need to be supplied to the actuary to enable him or her to assess the resulting assumption. The actuary should not have to be placed in the position of determining what "unable to assess for reasonableness" means in those circumstances, and be subject to the assessment being challenged in adversarial actions.

In addition, Sections 3.8 and 4.1(l) now require that, except for an assumption the actuary has not selected and is unable to assess for reasonableness, and a **prescribed assumption or method set by law**, the actuary must indicate whether the combined effect of assumptions is expected to have no significant bias – this requirement suffers from the same issues discussed above.

EROA is just one example. Other accounting assumptions, which are the responsibility of the plan sponsor, that the actuary may be unable to assess for reasonableness without doing substantial additional work include the likelihood of plant closings, likelihood and manner of settlements of participant lawsuits, etc.

We believe that the standard requiring the actuary to disclose if he or she is "unable to assess" an assumption "without performing a substantial amount of additional work beyond the scope of the assignment" is the proper standard.

Section 3.26 Documentation- It does not make sense to us that an actuary "should consider" preparing and retaining documentation (i.e., the actuary is not required to do so, but should just consider whether to do so) but, if the actuary decides to do so, the actuary "should prepare documentation in a form such that another actuary qualified in the same practice area could assess the reasonableness of the actuary's work or could assume the assignment if necessary". This leaves the actuary with a choice of preparing no documentation or preparing very detailed and comprehensive documentation, with no choice in between. We submit this makes no sense. We also note that the clause "or could assume the assignment if necessary" was deleted from the Modeling ASOP and the latest draft of the Assumptions ASOP and should be removed here as well.

We also recommend that the sentence "The actuary should refer to ASOP No. 41, section 3.8 for guidance related to the retention of file material other than that which is to be disclosed under section 4" be struck. ASOP No. 41 section 3.8 reads "Retention of Other Materials—An actuary may choose to keep file material other than that which is to be disclosed under this ASOP." ASOPs should not make statements like "An actuary may choose to do X" – of course an actuary might choose to keep file material, the actuary does not need permission from an ASOP to do so, and statements like this suggest that actuaries do not or should not do anything if not explicitly directed to by an ASOP. Because the statement is problematic, and does not add any requirement that does not already exist in ASOP No. 41, we request that it be struck.

Section 4.1 Required Disclosures in an Actuarial Report

Section 4.1(o)(5) – This section requires commentary on "the significance of the low-default-risk obligation measure with respect to the **funded status** of the plan, plan contributions, and the security of **participant** benefits." Since **funded status** is defined as any "comparison of a particular measure of plan assets to a particular measure of plan liabilities", there is no the **funded status** of a plan, and the significance of the low-default–risk obligation measure to this particular **funded status** is obvious – it is "a particular measure of plan obligations" and thus is a piece of this particular **funded status.** It is entirely unclear what the ASB expects the actuary to disclose in response to this requirement.

In addition, we note that this particular measure of **funded status** likely has little to no significance to plan contributions, or to security of participant benefits, unless this measure is based on the cost of terminating the plan now, the plan is expected to be terminated now and/or the plan sponsor is unlikely to be able to fund the plan as required (which the actuary is not in a position to evaluate). Even in those circumstances, an evaluation of the security of participant benefits would need to take into account PBGC guarantees, the possibility of recovery by PBGC of employer assets, etc. We believe this disclosure should be deleted.

Section 4.1(p) – This section should be modified to clarify that in situations where applicable law, regulations or accounting standards clearly specify how normal costs are to be allocated for all of the types of benefits provided by the plan, the description can simply be that the allocation was done in accordance with that law, regulations or standards.

Section 4.1(v) - We object to the addition of this requirement. It would be needlessly burdensome to the actuary to describe how all the considerations in section 3.17 have been taken into account in selecting a **cost allocation procedure** and a **contribution allocation procedure**, particularly when each of these terms explicitly include a number of component procedures.

Section 4.2 Disclosure about Assumptions or Methods Not Selected by the Actuary – Section 4.2(a) requires that an actuary disclose "any assumption or method that the actuary has not selected that individually or in combination with other assumptions or methods significantly conflicts with what in the actuary's professional judgement, is reasonable for the purpose of the measurement". Not only does this section fail to carve out assumptions that an actuary is unable to assess for reasonableness without doing significant additional work beyond the scope of the assignment, it fails to even carve out assumptions that the actuary is totally unable to assess for reasonableness. We believe there should be a carve out in both of these cases.

Thank you for this opportunity to comment on the Exposure Draft. If you have any questions concerning our comments, please contact us directly.

Sincerely,

Michael F. Pollack, FSA, EA, FCA, MAAA
Senior Director
203 326 5469
mike.pollack@willistowerswatson.com

Maria M. Sarli, FCA, FCA, EA, MAAA
Senior Director
678 684 0782
maria.sarli@willistowerswatson.com