



Cavanaugh Macdonald

CONSULTING, LLC

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May 29, 2015

ASB Comments
American Academy of Actuaries
1850 M Street NW, Suite 300
Washington, DC 20036

RE: Proposed ASOP for Pension Risk Assessment and Disclosure

To the Members of the Actuarial Standards Board:

Cavanaugh Macdonald Consulting, LLC thanks the Actuarial Standards Board for this opportunity to comment on the possibility of proposed ASOP for the assessment and disclosure of risk regarding pension obligations and contribution requirements. As a leader in providing actuarial consulting services to state and local government pension plans, our comments deal with some issues that may be specific to public plans rather than pension plans broadly.

Overall, we believe it is important to help the stakeholders understand what risks a pension plan faces, along with what risk reduction features are already part of the benefit design and funding structure. The definition of risk in section 2.2 is a very appropriate definition, since it acknowledges that not everything may occur as expected – whether favorable or unfavorable. In our experience of trying to communicate the risk to plan sponsors, we have some suggestions on a two of the questions proposed by the ASB in its Request for Comments. These are discussed in the remainder of this letter.

In question 1, the question of when the risk assessment should be performed is raised. While it seems natural to conduct this in conjunction with the annual valuation, we would suggest that language be included to allow the information to be provided after the valuation as part of an additional report. In some cases, the tight turn-around time required for a funding valuation does not allow for a meaningful risk analysis to be performed. Following the valuation report, however, there is time to perform a more thorough modeling of risk factors and then provide that information to the client. If the information is required to be included with the valuation, it may end up being solely qualitative and somewhat vague boiler-plate language that meets the standard without being useful.



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Question 4 asks for feedback on section 3.3 regarding assumptions used for the assessment of risk. We note that the definition of risk in section 2.2 is any deviation from the expected outcome, but that the requirements of 3.3 only consider deviations that are adverse. For an accurate assessment of the risk faced by a pension plan, both favorable and unfavorable outcomes must be considered. To only show adverse outcomes suggests that only bad things can happen and suggests that assumptions be more conservative – until the next year when still more adverse risk results are shown. This does not seem to help the sponsor understand the true risk.

Further, risk is not always symmetric, so showing upside risk can be helpful, too. For example, suppose we examine two similarly situated plans which differ in that one has a gain-sharing feature and uses favorable experience for immediate benefit increases rather improving the funded status to weather future unfavorable events. When examining the downside risk, both plans would seemingly be in the same situation. However, if the favorable scenarios are shown, it is clear that the gain-sharing plan does not benefit as much as the other plan, helping to expose how risk is actually working.

As section 3.3 reads in the proposed draft, the only assumptions allowed for risk assessment and disclosure are those that “should reflect moderately adverse but plausible outcomes.” We believe the language of 3.3 should be modified to at least allow, and preferably encourage or require, the assessment and disclosure of both favorable and unfavorable events.

In closing, we thank the ASB for this opportunity to comment on these matters. If you have questions regarding this letter, please do not hesitate to contact us.

Sincerely,

A handwritten signature in blue ink, appearing to read 'Edward Macdonald'.

Edward A. Macdonald, ASA, FCA, MAAA
President

A handwritten signature in blue ink, appearing to read 'Brent A. Banister'.

Brent A. Banister, PhD, FSA, FCA, MAAA, EA
Chief Pension Actuary