STATE OF CALIFORNIA

California Actuarial Advisory Panel

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~~Date~~May 1, 2015

~~Name~~
~~Address~~
~~Address~~Actuarial Standards Board
1850 M Street, NW, Suite 300
Washington, DC 20036-4601

RE:

~~Dear ____:~~

The California Actuarial Advisory Panel (CAAP) supports the ongoing improvement of Actuarial Standards of Practice (ASOPs) and ~~appreciate~~appreciates the opportunity to provide input to the Actuarial Standard Board (ASB) on the issue of assessment and disclosure of risk associated with measuring pension obligations and determining pension plan contributions.

The CAAP was created with the passage of Senate Bill 1123 in 2008 and consists of eight public sector actuaries appointed by public officeholders and agencies. Pursuant to California Government Code section 7507.2(2):

> "… the panel shall provide impartial and independent information on pensions, other post-employment benefits, and best practices to public agencies…."

The letter provides our comments to the proposed ASOP on risk assessment. In general, we want to note that the CAAP believes that ASOPs should be principles based rather than being prescriptive. Many of the comments provided in this letter are derived from this general philosophy.

Our comments are provided by answering the nine questions that were included in the exposure draft document.

Question~~s~~ 1

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The discussion draft that preceded this proposed ASOP indicated that a risk assessment should be performed for substantially all pension assignments. The exposure draft has limited the assessment to funding valuations, as defined in section 2.1. Do you believe this limitation is appropriate? Why or why not? If not, what other types of valuations should include risk assessments?

CAAP Answer to Question 1
We believe that this standard of practice should be broader and cover more than pension funding valuations. If performing a risk assessment is deemed necessary for a pension funding valuation, it could be as important to do one for cost studies where an employer is looking at modifying the benefit structure for its employees. If it is deemed necessary to perform a risk assessment for a funding valuation, then why wait until a benefit design has been implemented to perform a risk assessment until such benefit has been implemented. Under the proposed ASOP language, an actuary would not be required to perform a risk assessment of a benefit change until such time the benefit change has been implemented and the actuary performs the next funding valuation. Similarly, this standard should be broader and apply also to Other Post Employment Benefit (OPEB) funding and/or financial reporting valuations, especially considering their similarities to pension valuations. We want to note that as currently worded, it would be difficult to simply add OPEB valuations to the scope of this ASOP without modifying other sections. This issue will be addressed as part of other comments we are submitting later in this letter related to section 3.7 of the draft ASOP.

Question~~s~~ 2
Does the language in the exposure draft provide sufficient guidance to actuaries
performing risk assessment work? If not, what additional guidance should be provided?

CAAP Answer to Question 2
As stated earlier, the CAAP supports that ASOPs should be principles based rather than being prescriptive. The examples of risk to be assessed in section 3.2 provide guidance but we believe additional examples should be provided. Since we support broadening the application of the ~~is~~ ASOP to OPEB valuations, adding a health care trend rates risk to the list under 3.2 would be appropriate as well. We believe it is also adding embedded option risk (e.g. gain sharing provisions and cash balance interest rate crediting) to the list of examples of risks.

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All the risks listed in the current version of the ASOP address risk related to actuarial assumptions. We believe a non-assumption risk like funding policy should be listed. This example should include the risk of either the plan sponsor's willingness to contribute the actuarially determined funding requirement or the funding policy not being adequate to provide full funding of the benefits. Even though one could argue that these last two risks could fall under section 3.2.e., we believe listing them separately is more appropriate.

Question 3
Is the language in the exposure draft sufficiently flexible to allow for new developments in this area of actuarial practice?

CAAP Answer to Question 3
We believe that the language of the draft ASOP provides sufficient flexibility to allow for new developments in the area of risk assessment.

Question 4
Do you agree that the guidance in section 3.3 regarding assumptions used for the assessment of risk should include moderately adverse but plausible outcomes? If no, what guidance would you propose?

CAAP Answer to Question 4
We agree with the guidance provided in section 3.3 when it comes to deterministic projections. We think that the guidance is reasonable for deterministic projections and that it should not require inclusion of tail occurrences which have a very low likely of occurring. However, we note that in the event an actuary uses stochastic modeling to perform a risk assessment that it is appropriate to reflect in the stochastic projections the likelihood that a tail event may occur. The language of the proposed ASOP should be modified to reflect this distinction.

Question 5
As discussed in section 3.5, for a funding valuation of a plan, the actuary should perform a risk assessment, which may be quantitative, qualitative, or both. Should the guidance require the actuary to use professional judgment in choosing which type of assessment (quantitative, qualitative, or both) to use? For example, if an actuary believes a quantitative assessment should be performed, do you believe providing a qualitative assessment instead of a quantitative assessment should be considered appropriate actuarial practice?

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CAAP Answer to Question 5
Yes, we believe tYes, we believe the actuary should use professional judgment in determining the type of risk assessment that should be performed for the plan. To ensure that it is clear that the determination of performing a risk assessment should be left to the actuaries judgment, we suggest the first sentence of section 3.5 be modified to say that the actuary should consider providing a risk assessment rather than saying should perform. We believe using this wording ensure this ASOP remains principle based and also would be consistent with the last paragraph of section 3.5 that mentions an actuary may rely a separate report. We recommend however that the wording of the first paraghraph be modified slightly. The first sentence should be modified by using the word "provide" instead of "perform". As suggested, the new sentence would read as follows:

> "For a funding valuation of a plan, the actuary should provide a risk assessment, which may be quantitative, qualitative-, or both."

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We also recommend that the wording of the second paragraph of section 3.5 be re-written. As currently worded, it is unclear what is tthe intent of this paragraph is unclear.

We recommend that the last paragraph of section 3.5 be modified to make it clear that the actuary may rely or make reference to a report that the actuary or another party has produced. As currently written, the current ASOP could be interpreted as not allowing an actuary to rely on a separate report that the actuary has produced. -The same wording appears in section 3.7 and should be changed as well.

Question 6
Plan maturity measures have been included as a potential disclosure item to assist intended users in understanding the risks associated with the plan. Are there additional measures that may be disclosed that are significant to understanding the risks of the plan? If yes, what measures would you recommend as a disclosure item?

CAAP Answer to Question 6
Yes. We believe that the ratio of the actuarial accrued liability to payroll is as important an indicator as the ratio of market value of assets to payroll included in the current draft ASOP. The ratio of liability to payroll is a good indicator of the plan's volatility caused by the plan demographics or the benefit structure and a good indicator of what the market value of

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assets to payroll ratio would be if the plan were to be fully funded.of long term volatility, especially in cases where a pan is underfunded and the asset to payroll ratio may be temporarily lower due to low funding levels. The ratio of liability to payroll is also a good indicator of sensitivity to experience gains and losses and to assumption changes such as the discount rate and mortality.

Question 7
Do you agree with the use of a threshold for requiring mandatory quantitative assessment that is based on the actuary's professional judgment? If not, what threshold do you believe should be used?

CAAP Answer to Question 7
We agree that the decision as to whether or not to provide a risk assessment should be based on the actuary's judgment. We recommend that the wording of the first paragraph of section 3.7 be changed from saying the actuary should perform to say that the actuary should consider performing a quantitative risk assessment. As currently written, section 3.7 deviates from the fact ASOP should be principles based and not being prescriptive.

Question 8
Do you believe that the term "large plan" in section 3.7 is sufficiently clear that an
actuary will be able to apply it in practice? If not, what clarification would you suggest? Are there other characteristics that should be specified in determining "large plan"?

CAAP Answer to Question 8
As stated in CAAPthe aAnswer to Qquestion 7, the decision as to whether or not to provide a risk assessment should be based on the actuary's judgment. For this reason, when an actuary uses his or her judgment to determine if a risk assessment should be performed, the size of plan should not be the only factor. A better threshold may be the materiality or impact of the risk.

We believe that the ASOP should be changed and not include the four items listed to describe what a large plan is. We propose that only the first sentence of paragraph four remains since the intent is to leave the determination to the actuary's judgment.

Question 9

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Is every five years an appropriate period for performing a mandatory quantitative
assessment for a "large plan" in the absence of significant changes, as described in section 3.7?

CAAP Answer to Question 9
To ensure this ASOP remain principles based, section 3.7 should be changed and not include any specific time period over which a risk assessment should be produced and should not also dictate the frequency of such assessments. –We propose the wording be changed to say that when performing a risk assessment that the results should be projected over a period long enough to be reasonably sufficient to illustrate the risk being assessed. Prescribing a period of at least ten years goes against an ASOP being principles based. Similarly, the requirement for a risk assessment to be performed at least every five years should be removed. We propose the wording be changed to say that a risk assessment should be performed periodically and leave the determination of the appropriate frequency to the actuary's professional judgment.

The changes we propose for section 3.7 would also make it easier to broaden the impact of this ASOP beyond funding valuation for pension plans as we stated earlier in our comments.

Conclusion
The CAAP supports adding an Actuarial Standards of Practice on the topic of assessment of risk. However, such standard of practice should be principles based and avoid imposing defined requirements on actuaries as we stated in our comments.

Improvement to ASOPsctuarial Standards of Practice should result in better actuarial work over time and be responsive to the needs of the public. We believe this application of this standard of practice should be broader and not be limited to pension funding valuations.

In closing, we wish to thank you again for this opportunity to provide input. If you have any questions regarding the comments provided by the CAAP, please contact XXXXXXX.

Sincerely,

Paul Angelo

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Chair, California Actuarial Advisory Panel

cc: Panel members
John Bartel, Vice Chair
Ian Altman
David Driscoll
Leslie Finertie
David Lamoureux
Rick Reed
Graham Schmidt

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