TOWERS WATSON

May 25, 2012

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 Towers Watson to the Proposed Revision of Actuarial Standard of Practice (ASOP) No.4, *Measuring Pension Obligations and Determining Pension Plan Costs or Contributions*, as requested in the Exposure Draft of January 2012. Towers Watson is a global human capital and financial management consulting firm specializing in employee benefits, human capital strategies, and technology solutions. Towers Watson employs approximately 14,000 associates on a worldwide basis, over 1,100 of whom are members of U.S. actuarial bodies subject to the standards. The undersigned have prepared our company's response with input from others in the company.

Our comments generally support four central themes that we believe apply to the Actuarial Standards of Practice.

- The ASOPs should be built upon the fundamental premise that an actuary needs to apply judgment based on the facts and circumstances of each particular situation. No written standard can anticipate every situation that actuaries will confront. In recognition of this fact, the standards should not be overly prescriptive and should not seek to substitute rules for the actuary's reasonable professional judgment.

- The ASOPs should set forth minimum professional standards, not best practices. The ASOPs can and will be used against members of our profession in litigation. Incorporating best practices into the ASOPs will inevitably lead to characterization of those practices as minimum acceptable standards in litigation and client disputes. This places actuaries at unnecessary and significant risk. While we support the efforts of the actuarial profession to encourage the use of best practices, we do not believe that the ASOPs are the appropriate means to achieve that objective.

- The ASOPs should not impinge upon the terms of the engagement between an actuary and his or her Principal. Actuarial services subject to the standards are already highly regulated by governmental and other authoritative bodies. The terms of engagement are based upon a mutual understanding of those requirements by the actuary and the Principal. The ASOPs should not require the actuary to perform additional work that is outside the scope of the engagement, is not requested by the Principal, and for which the actuary is unlikely to be compensated.

- The ASOPs should not be written or interpreted in a manner that allows readers to presume that actuaries serve the "general public." Our company's actuaries are engaged to serve the company's clients. While members of the public who are not our clients may benefit from our work, we nevertheless perform and deliver this work only for our client. No other person or entity can expect to rely on our work. We strongly believe that any ASOP that explicitly provides for or allows a presumption that actuaries perform work for the general public will expose actuaries to unwarranted and unmanageable risk.

Our specific comments on the Exposure Draft are outlined below.

Integration with Other Actuarial Standards of Practice

We observe the significant overlap with other standards, most notably ASOP No. 27 and the future standard addressing pension risk. Such overlap is unwieldy. Related information can be found in different standards, and the review of different standards at different times can lead to internal inconsistency. We suggest that each definition exist in only one place, and that it be incorporated only by reference in the standards for which it is necessary. We believe that the issuance of the Exposure Draft of the Introductory Actuarial Standard of Practice represents a positive step in clarifying foundational definitions that are referenced by many standards. Explicit reference to that document would be welcome in ASOP No. 4. Many actuaries are not aware that terms such as “should” and “significant” are formally defined within the standards, and they instead rely on the general uses of these terms. The Actuarial Standards Board might consider expanding the Introductory Standard or creating a stand-alone glossary of actuarial terms.

We suggest that the title of ASOP No. 4 be changed from “Measuring Pension Obligations and Determining Pension Plan Costs or Contributions” to “Measuring Pension Obligations, Costs or Contributions.” Actuaries play a significant role in the financial reporting related to pension plans and in assisting plan sponsors to explore contribution alternatives. Actuaries do not themselves have overall responsibility for the financial reporting or contributions made, and therefore do not “determine” costs or contributions. This phrasing can also be found in many other places in the Exposure Draft, and we suggest that it be addressed consistently throughout.

Section 2. Definitions

2.7 Contribution – This definition is largely unchanged from the existing standard, and it does acknowledge that the actuary only calculates potential contribution amounts. Amounts actually paid are not at the discretion of the actuary. But this is not consistent with the general use of the word. Readers of actuarial work products will typically not cross-check definitions of frequently-used, non-technical words against the definitions of ASOP No. 4. A definition of the word “contribution” that actually means something else is likely to lead to confusion. It would be better to use “potential contribution” when this sense is intended.

2.9 Cost – This definition, also unchanged from the existing standard, refers to cost as a portion of plan obligations. But the commonly used meaning of cost encompasses the calculations required for financial reporting by the FASB and the IASB. These cost measures are not simply portions of the obligations; they include other amounts such as interest, amortization and expected return on plan assets. An examination of the use of the word “cost” within the Exposure Draft makes it seem as if these periodic costs are intended to be encompassed by the definition. We suggest that the definition therefore be generalized, perhaps to

> “The amount assigned to a period for purposes other than funding. This may be a function of plan obligations, normal cost, expenses and assets.”

2.12 Fully Funded – We would like clarification that “any other phrase that conveys a similar message” applies only to descriptive statements. The mere presentation of numeric results in which the asset value exceeds an actuarial present value of benefits does not imply that the actuary has declared that the funded status is sufficient to accomplish any objective. The requirements of section 4.1(p) should therefore not be triggered.

2.13 Funded Status – We suggest reconsideration of two passages:

- “A plan’s funded status can be measured in many different ways and the measurement can easily be misunderstood or misinterpreted.”
- "Because of the role that funded status often plays in the conclusions a user derives from the actuary's work product…”

Definitions should only state the meaning of terms that are used in the rest of the document, and should generally be free of associated context and perspectives. We did not observe similar statements in other definitions, and it would therefore seem stylistically consistent to strike these statements. If the Pension Committee wishes to retain them, we suggest the statements be relocated to either the introduction or an appendix.

In addition, section 2.13 defines funded status as “a comparison of a particular measure of plan assets to a particular measure of plan liabilities”. The word “comparison” is not defined, although showing a ratio or a difference is cited as an example. We request clarification that merely showing a measure of assets and a measure of liabilities in a work product, whether or not in close proximity, is not a “comparison” triggering the requirements of sections 4.1(n), 4.1(o) and 4.1(p).

Section 3. Analysis of Issues and Recommended Practices

3.5 Plan Provisions

Section 3.5.3 addresses plan provisions that are difficult to value with traditional deterministic techniques. Such provisions certainly exist, but the criteria provided in this section are inappropriately broad. They include provisions “in which future benefits vary asymmetrically with future economic or demographic experience relative to the estimated projected benefits based on a particular set of actuarial assumptions.” But the majority of plan provisions fit this description.

For example, consider a simple benefit equal to 100% of final salary that is to be paid in 20 years. Current salary is $25,000. The compensation increase assumption selected for a particular present value calculation is 3% per year. Projected benefits using various compensation increase assumptions are:

Assumption	Benefit	Difference from using selected assumption
2%	$ 37,149	$(8,004)
3% (selected)	$ 45,153	N/A
4%	$ 54,778	$9,625

One might interpret these results to mean that even this extremely simple benefit varies asymmetrically with future economic experience. The same dynamic would be present for the vast majority of provisions, not only for those that could be fairly described as difficult to value. We suspect that this was not the intention of the Pension Committee. Perhaps this could be clarified with a statement indicating that the effects of compounding over time would not be considered asymmetry.

Although the Exposure Draft allows the actuary to use professional judgment in addressing the provisions covered by this section, additional disclosure is required by section 4.1(h). Unduly broad application of this requirement would be onerous to the actuary. In addition, meaningful disclosures could be obscured by the far more numerous meaningless ones.

Note also that this section repeats the problematic phrasing “determining plan contributions.” As we commented earlier, the actuary does not determine contributions in the generally used sense of the word. (We note that the Exposure Draft does define “contribution” in a way which makes this phrase technically correct. This is an example of why we suggest revising the definition.) The word “measuring” would be more appropriate.

3.7 Types of Actuarial Present Values

Sections 3.7.1 and 3.7.2 of the Exposure Draft refer to the allocation of plan assets, which may be confusing to some readers. Allocation can mean other things in the context of pension plans, such as the allocation of assets to individual accounts. It would be more accurate to classify the present value depending on whether the discount rate reflects the expected return on plan assets. The transmittal memorandum itself uses this construction: “... a discount rate that reflects the expected investment return of the assets supporting the pension plan.” Similar phrasing should be present in the ASOP itself.

Regarding section 3.7.3, we believe that it would be inappropriate to define market-consistent measures in the standard of practice at this time. Although we strongly support updating the standards to keep pace with advances in actuarial practice, the standards should not prescribe techniques that have not yet been generally adopted. The application of market-consistent values to pension practice is still largely theoretical, and it would be premature to include it in standards now. It should certainly not be a required calculation; we are not aware of any minimum funding or financial reporting standards that require this present value measurement. If the calculation is not required, then there is no need to define the term in the standard. A more appropriate treatment of an evolving topic such as this would be broader discussion in a practice note.

We do note that the definition of market-consistent present values has been improved from the initial Discussion Draft. It is now appropriately broad and principles-based. This recognizes that the determination of market-consistent values for pension plans is embryonic. We observe that market-consistent present values are considered a subset of present values not based on plan assets. This classification would be reinforced if the definition were included as an item in 3.7.2 rather than as a separate section.

The second part of section 3.7.3 introduces three examples of situations in which an actuary might use market-consistent present values. The language used for these examples is much more prescriptive than that found in the first part of the section. It quite assertively says what the actuary “should” do – not what the actuary “should consider” or “may” do. According to the current Exposure Draft of the Introductory Standard of Practice, “should” indicates appropriate practice, and failure to follow the practice constitutes a deviation from the ASOP. It is not fitting to use inflexible language in this section; these calculations are rarely performed, the purposes of the measurements would vary and actuarial practice in this area is not mature. The ASOP should allow actuaries to exercise greater professional judgment as practice in this area evolves.

3.10 Measuring the Value of Accrued or Vested Benefits

The example in 3.10(f) uses a problematic phrase: “severely backloaded.” The word “severely” is not defined, so a reader would not know what constitutes “severe” backloading. Yet it has a strongly negative connotation. We believe that the example does not contribute to 3.10(f) and that it can simply be eliminated. Failing that, a less charged word such as “significantly” would be more easily interpreted.

3.13 Allocation Procedure

We suggest that the final sentence of section 3.13 be moved to the end of the opening paragraph of 3.13, immediately before 3.13.1. The sentence, which is quite important, reads: "This standard does not require the actuary to evaluate the ability of the plan sponsor or other contributing entity to make contributions to the plan when due." It seems clear from both the meaning and the indentation of this sentence that it is intended to apply to all of 3.13. Its location, however, could lead a reader to believe that it applies only to 3.13.5.

We believe that other aspects of this section place an impractical burden on the actuary, imposing unreasonable requirements for analysis that will often be outside the scope of the agreement with the Principal. This overreach conflicts with the core themes expressed at the beginning of this letter.

Sections 3.13.2 and 3.13.3 both require that the actuary assess whether a contribution allocation procedure is "consistent with the plan accumulating adequate assets to make benefit payments when due." This would be extremely complex. Consider a plan that is closed to new participants. Under a unit credit cost method, the normal cost would increase for each continuing active participant, and it would be expected to increase for the plan in total. But at some point in time, expected retirement and termination will reverse this trend. Normal cost would be expected to decrease until the last participant leaves active service. Determining the implications of a contribution allocation procedure that incorporates normal cost could require analysis of this dynamic. Many more examples can be reasonably constructed. Participants earn new benefits, often with different benefit formulas in play. New participants enter open plans. Benefits are paid out in several different forms, potentially converted on bases other than those used for the determination of present value. Requiring actuaries to perform unrequested analyses that include these issues is entirely impractical; requiring actuaries to perform unrequested analyses that neglect to include them could mislead users.

We do understand and support the motivation for this requirement; a contribution allocation procedure should not be selected without due care. We therefore have no objection to the requirement as stated in 3.13.2. But we believe that it should be stricken from 3.13.3, which addresses situations in which the actuary did not select the contribution allocation procedure.

Sections 3.13.4 and 3.13.5 go even further. They specifically require that the actuary evaluate the expected pattern of future cost, funded status and contributions. If this analysis were not desired by the Principal, it would represent significant work outside the scope of the engagement. Such elements require a robust forecast model for more than just the assets and liabilities. Rules, regulations, methods and approaches to simulate the future measurement of cost and potential contributions would also need to be included. Building such a model is a complicated actuarial undertaking. These projects require a host of additional assumptions. They are often performed using software that is separate from the work that has been agreed to by the Principal. They may very well require the involvement of actuaries who specialize in such work.

We also note that the requirements of 3.13.4 and 3.13.5 are not clear. These sections require the actuary to assess "cost progression implications." This reference to cost is confusing in this context. We do not know whether this is intended to describe the benefit cost under applicable financial reporting standards or some other measurement. Regardless, this analysis should not be required. The expectation of declining future funded status or increasing future contribution requirements are also ambiguous. Are future entrants considered? Is it considered a pattern of increasing future contribution requirements if employment levels are expanding and the group covered is expected to grow, even if contributions are expected to remain stable per person or as a percentage of payroll? Is the requirement triggered if per-participant costs escalate but the total contribution requirements decline because the group is closed? Many of these ambiguities are related to whether all anticipated demographic shifts would be covered by the reference to “expected increases in participant compensation.” This exclusion for contribution increases associated with increasing compensation seems odd. Consider the typical situation in which the unit credit cost method is applied to a plan with benefits based on final-average compensation. The application of current compensation levels to benefits attributable to past service can lead to increasing contribution requirements. These increases can significantly exceed the rate of pay increase itself and can be of greater consequence than effects for which the Exposure Draft would require disclosure.

Even if these technical matters were resolved, our concerns about 3.13.4 and 3.13.5 would remain. The ASOPs should not require actuaries to produce additional work products that are not wanted or contracted for by their Principals. Actuarial services would become prohibitively expensive if actuaries charged for these tasks, and plan sponsors would hesitate to involve actuaries when they were not compelled to do so. This would be contrary to the interest of actuaries, plan sponsors and plan participants. We note that section 3.15 (volatility) appears to follow the principles that we favor. It does not require that volatility be considered if that is not within the scope of the engagement, but it provides guidance if evaluating volatility is within scope.

Section 4. Communications and Disclosures

We understand that the Pension Committee wishes to ensure that inappropriate conclusions are not reached by readers of actuarial work products. We share this objective, but have concerns about the likely effectiveness of the approaches outlined in the Exposure Draft.

We believe that the disclosure and communication requirements established by the ASOPs should align with these three critical points:

- Actuarial analyses are intended only for specified users. These should be clearly defined.
- The actuary does not, merely by communicating results of specific measurements and analyses, make any claims about any other issues. None should be inferred.
- Future results are likely to vary for many reasons, including plan experience different from that assumed and changes to assumptions.

The Exposure Draft, unfortunately, takes a very different approach. The Pension Committee seems to have tried to anticipate hypothetical mistaken interpretations that might be made by unidentified readers of actuarial work products. Extensive analyses and declarations are then required to explicitly address these hypothetical misinterpretations. We see this perspective made manifest in paragraphs n, o, p and q of section 4.1.

But it is impossible to anticipate and address all possible mistaken inferences. In fact, trying to do so may increase confusion. If our suggested strategy were implemented, the Principal would receive a concise and clearly defined description of the analysis that was performed, including its purposes and intended use. It would describe exactly what was done in a manner that mitigates the possibility of mistaken inferences. The Exposure Draft, on the other hand, would confront the reader with the answers to many questions that were not asked. Many of these statements might be only tangentially related to the analysis that was requested. This does not work to improve clarity.

In addition, the additional analyses would place a greater burden on the actuary. The cost for these analyses might also be transferred to the Principal, either in whole or in part. Neither party, however, would benefit from this additional work.

4.1 Communication Requirements

Paragraph 4.1(h) addresses communication requirements for difficult-to-measure plan provisions. We noted earlier that the identification of these provisions is overly broad. We wish to provide additional feedback about the communication requirement itself. ASOP No. 41, *Actuarial Communications*, was updated little more than a year ago. It requires that “the actuary should … identify the methods, procedures, assumptions, and data used by the actuary with sufficient clarity that another actuary qualified in the same practice area could make an objective appraisal of the reasonableness of the actuary’s work as presented in the actuarial report.” However, paragraph 4.1(h) of the Exposure Draft requires “a description of the methods used ... such that another actuary could make an assessment as to the reasonableness of the methodology used.” We prefer the language of ASOP No. 41 to the proposal in the ASOP No. 4 Exposure Draft. First, it makes clear that the actuary reading the communication must be qualified in the same practice area. Second, it addresses the reasonableness of the work presented in the report, not the methodology. According to paragraph 3.14(a) of the Exposure Draft, alternative methodologies are acceptable if “the actuary reasonably expects the answer to be substantially the same as the results of detailed calculations.” The methodology itself is not what must be judged reasonable – the result of the work product is. The communication of approaches should therefore facilitate evaluation of the reasonableness of the result.

We consider the discussion of implications introduced by paragraph 4.1(i) to be inappropriate, and we find the examples suggested in the Exposure Draft troubling. They speculate about the incentives that might be introduced by the selection of an actuarial present value type. We are not aware of any other topics for which comparable statements are required. An extremely compelling rationale would be necessary to justify such a requirement. None is apparent to us, and none was provided by the Actuarial Standards Board in the transmittal memorandum of the Exposure Draft.

We also find the proposed requirement to be unclear and impractical. Each example speculates about the incentives introduced by the selection of an actuarial present value type. But these statements lead to many questions. Whose incentives are these? What are their objectives and time horizon? What is their decision-making authority? How is the actuary expected to have knowledge of these? What if the selection was imposed by law or regulation, rather than being selected by either the actuary or the plan sponsor? In such a case, no consideration could have been given to alternative approaches even if the responsible party would have preferred a different actuarial present value type. Yet these disclosures could make it seem as if these hypothetical incentives had led to the selection.

Paragraph 4.1(l) states the communication requirements related to section 3.13. Please refer to the comments in “3.13 Allocation Procedure” above, in which we express concerns about the appropriateness, practicality and likely effects of these requirements.

The requirements of paragraphs 4.1(n) and (o) insert themselves into the terms of the engagement, requiring calculations that the Principal may not have requested. In addition, they may be irrelevant or even misleading. For example, consider a situation in which the actuary must certify that the funded status of a U.S. qualified pension plan is sufficient for continuing benefit accrual. This certification must be made in accordance with rigorously defined rules that do not necessarily use the market value of assets. They may rely on modified and smoothed asset values. But the Exposure Draft would require that additional information be provided along with this targeted, prescribed statement of funded status. To comply, actuaries would need to prepare and attach additional statements to forms such as Schedule SB and AFTAP certifications. Although these flaws are clearest for prescribed communications, we have the same objections for communications that are not prescribed. As long as the actuary clearly describes the calculations that were performed, the ASOPs should not require additional calculations that were not requested by the Principal.

Paragraph 4.1(p) identifies four additional communications required when a plan is described as fully funded. Our comments on section 2.12 already note the ambiguity of the trigger; our comments here address the communication items themselves. This paragraph would require that the actuary specifically address issues that may be unrelated to those measurements requested by the Principal. These issues seem to have been introduced only because of a belief that unspecified readers might otherwise become confused. We repeat our fundamental premise: It would be more appropriate, effective and practical to establish a standard that requires the clear description of requested analyses, not one that requires an assortment of additional analyses. The three points articulated at the beginning of our comments on Section 4, Communications and Disclosures, would provide a sound basis for the approach that we recommend.

We also offer the following observations related to each of the four specific items in paragraph 4.1(p) (keeping in mind that we believe our three points above would best replace all of the communications proposed in 4.1(p)):

1. Whether the plan's market value of assets equals or exceeds the estimated cost to settle benefit obligations is not a straightforward question to answer. In the first place, it is not clear what is meant by settlement in this context. Even if an estimate is acceptable under many circumstances, this would not suffice for plans that are funded at levels close to the settlement cost. Moreover, whether a settlement could have been effected at a previous date may be of limited relevance at the time of the communication. We believe that this proposal is not clearly defined, practical or useful. It would require an expenditure of resources to answer a question that had not been asked by the Principal, was not required by law or regulation, and provided little value.

2. Every determination of funded status is a temporary measure at a particular point in time. A requirement that this statement be applied to a plan that is 100% funded on a particular measure, but not to a plan that is 99% funded, does not make sense.

3. The third item is also not meaningful. As noted for the second item, every measure of funded status is temporary. This item also introduces another problematic requirement. On what basis should an actuary assess the risk that a plan's funded status could deteriorate? This could require many advanced analyses, such as stochastic forecasts and detailed experience studies. The cost would be prohibitive. Even if these studies were performed, what level of risk would be considered "significant?" What risk factors would be considered? This requirement in the Exposure Draft is entirely impractical.

4. We find that the fourth item would have little value to users. It seems to be a boilerplate statement that only clutters up the communication with jargon. Although it would not need to impose a great burden on the actuary, that is because it could be used from one situation to the next with little modification.

Paragraph 4.1(r) addresses changes in assumptions and methods. We believe that an explanation of the information and analysis that led to assumption changes could be needlessly burdensome. If this work were not requested by the Principal, the actuary would not be compensated for these efforts. More importantly, the rationale for changes in certain assumptions (such as compensation, termination or retirement rates) may be based on business information that the Principal would not want disclosed. In fact, disclosure of this information may be prohibited by the terms and conditions of the actuary's contractual arrangement with the Principal. We also note that all changes to cost or contribution allocation procedures will trigger extensive disclosure requirements, even if these methods were set by another party or were prescribed by law. The reason that the actuary makes a change in such a case may be simply that the actuary has been instructed to do so. These methods are not under the control of the actuary, and no further reason for the change is necessary. The actuary may not know more about the reason for the change, and the actuary may not have performed any additional analysis about the effects of the change. In some cases, these reasons may also be based on business information that the Principal would not want disclosed.

We do not think that it is appropriate to require that the reasons for changes be disclosed in this manner. Even if more limited disclosure is sometimes required, the situations noted here related to client confidentiality should be explicitly exempted.

4.2 Additional Disclosures

Paragraph 4.2(b) addresses assumptions and methods that were set by another party. It refers the actuary to section 4.3 of ASOP No. 41. That section of ASOP No. 41, in turn, provides disclosure requirements when either: (1) the assumption or method significantly conflicts with what, in the actuary's professional judgment, would be reasonable, (2) the actuary was unable to judge the reasonableness of the assumption or method without performing substantial additional work, or (3) the actuary is not qualified to judge the reasonableness of the assumption or method. But ASOP No. 41 does not impose a disclosure requirement when the actuary finds the assumption or method to be reasonable. Section 4.2(b) of the Exposure Draft should be modified to clarify that there is no disclosure obligation for prescribed assumptions or methods set by another party that do not significantly conflict with what the actuary considers to be reasonable.

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

Sincerely,

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