Introduction to ASOP 51

BY JUSTIN GREINDL
AMERICAN SOCIETY OF PENSION PROFESSIONALS AND ACTUARIES

AUGUST 13, 2018

For those who may have been preoccupied with last year's deadline season, the ASB adopted a new ASOP last September 2017. This ASOP has been a few years in the making, with the First Exposure Draft in December 2014 and the Second Exposure Draft in June 2016. We are now approaching the effective date where this standard will apply to any work with a measurement date on or after Nov. 1, 2018.

The new "Pension Risk" ASOP as is it commonly referred to provides additional guidance beyond ASOPs 4 and 41 regarding disclosure of inherent risks with the measurement of pension obligations and actuarially determined pension contributions. The main intention is for the client/intended user to gain a better understanding of the underlying potential of future variance compared to current valuation results. For example, often times we run valuations and contribution recommendations when we already know the following year's segment rates, asset performance, or demographics have changed significantly. Therefore, this standard fills in some gaps with prior ASOPs for us to rely upon.

However, it is important to note that this standard does not provide guidance on management of pension risk. Any guidance conflict with ASOPS 4, 27, 35, or 44 would result in ASOP 51 governing.

Recommended Practices

In addition to calculating typical actuarial results such as Funding Targets, Target Normal Costs, Funded Status, etc., this ASOP requires that the actuary identify potential risks that "may be reasonably anticipated to significantly affect the plan's future financial condition." The examples given (non-exhaustive) are:

- Investment risk
- Asset/liability mismatch risk
- Interest rate risk
- Longevity/demographic risks
- Contribution risk

How is it generally accepted that an actuary measures these potential risks? Section 3.4 indicates various metrics such as scenario testing, sensitivity testing, stochastic modeling, stress testing, and actuarial present value point estimate comparison. Many of you may be thinking the same thing I am — does it make sense to run stochastic modeling (1000+ scenarios) or a Monte-Carlo simulation for a startup one-person plan? Potentially not, and this is addressed by Section 3.6 and noted below. Instead, a simple sensitivity analysis or scenario test could give an ample picture of future potential risk.

In order to perform a risk assessment, Section 3.5 calls on the actuary to vary one or more assumptions of the underling base calculation in order to determine plausible alternative outcomes. These assumptions can be based upon economic and demographic analyses and may include the input of experts or principals, again assuming justified by the actuary's judgment unless noted otherwise.

Based upon the initial risk metric findings, the actuary will determine if additional comprehensive analysis and disclosure is needed, and to do so must consider the following:

- Findings of the initial risk assessment
- Size of the plan
- Size of the plan relative to the plan sponsor
- Maturity of the plan
- Funded status
- Asset allocation
- Contribution allocation procedure
- Indication(s) the plan sponsor may not make current and/or future recommended contributions
- Length of time since previous assessment
- Any significant changes since previous assessment

These considerations can assist us within the small plan world to determine which risk metrics and methods may be sufficient for our clients. One of these named considerations is Plan Maturity, and the standard further requires the actuary disclosure Plan Maturity metrics should any of the following be helpful for the intended user in understanding the associated risk:

- Ratio of market value of assets to active participant payroll
- Ratio of retiree liability to total liability
- Ratio of a cash flow measure to market value of assets
- Ratio of benefit payments to contributions
- Duration of the total liability

A further required supplement compels the actuary to, again if helpful, disclose and provide commentary on available historical information relevant to better comprehending plan risks, such as:

- Plan maturity measures
- Funded status
- Actuarially determined contribution
- Actuarial gains and losses
- Normal costs
- Plan settlement liability

Disclosure Requirements

ASOP 51 concludes by prescribing communication and disclosure guidance when material and relevant. These disclosure requirements can be summarized as follows:

- Identify the risks and results of the risk assessment performed pertaining to future financial condition (Sections 3.2 and 3.3)
- Describe each significant assumption or method used in analysis (Sections 3.4 and 3.5)
- Recommend a more detailed risk assessment, if applicable as determined by actuary's judgment (Section 3.6)
- Comment on material and relevant plan maturity metrics (Section 3.7)
- Detail any significant historical values related to actuarial measurements (Section 3.8)
- Indicate any limitations or constraints regarding the comprehensiveness of the risk assessment
- State source of any assumption or method set/prescribed by another party, including commentary on reasonableness and any potential conflicts with the assessment
- Describe reliance on other sources if disclaiming liability, or any deviance from stated guidance

In summary, the intention is for the client/intended user to gain a better understanding of the plan and any significant future anticipated risks. While this will require additional calculations, consulting, and overall effort, much of this we may already consider and even perform already so this can essentially memorialize the process. Remember to mark your calendars for all measurements on/after Nov. 1, 2018, and happy risk assessing!