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New Standard for Disclosure of Pension Risks

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While our clients and the general public may be comforted to know that members of the actuarial profession have a robust set of standards by which they must abide, specific Actuarial Standards of Practice (*ASOP*) are typically of little interest to anyone outside of the profession; however, ASOP 51, the most recent standard, may be an exception. ASOP 51, titled "Assessment and Disclosure of Risk Associated with Measuring Pension Obligations and Determining Pension Plan Contributions," provides guidance to actuaries in determining and communicating the risks that the actual cost of a pension plan may differ significantly from the expected cost of a pension plan. As a result, actuaries may be required to provide additional information as part of their annual actuarial valuation of defined benefit pension plans with measurement dates on or after November 1, 2018.

ASOP 51 is meant to help plan sponsors better understand and manage the risks associated with their pension plans—certainly a worthwhile goal. Risk, of course, is not necessarily a bad thing—it is simply the chance of an unexpected outcome: good or bad. The general role of actuaries is to understand, and when possible, quantify risks related to a specific client assignment. When actuaries warn their clients about certain risks, it is typically with an eye towards potential loss.

ASOP 51 does not require an actuary to perform *numerical calculations* in order to assess each specific area of risk. It does, however, require actuaries to use their professional judgement as to whether a particular risk analysis is warranted and, if so, to recommend to the client that the risk potential be quantified if "a more detailed assessment would be significantly beneficial." Such calculations could be beyond the scope of the project agreed to by the client and the actuary, so a requirement to quantify all risks would invariably result in disputes over the fees associated with projects. Ultimately, the decision to undertake such an extensive project must be at the discretion of the client.

ASOP 51 defines risk as, "The potential of actual future measurements deviating from expected future measurements resulting from actual future experience deviating from actuarially assumed experience." The standard goes on to identify some of the typical risks encountered by defined benefit pension plans:

- Investment risk—actual investment returns will be different from the expected return;
- Asset/liability mismatch risk—asset and liability values will move in opposite directions under certain economic conditions;
- Interest rate risk—actual interest rates in the future will be different from the expected rates;
- Longevity and other demographic risk—plan demographics (e.g., mortality, disability, retirement, etc.) will differ from expectations;
- Contribution risk—contributions to the plan will not be made in accordance with the plan's funding policy.

The probability of occurrence of some of these risks may not be independent of one another. For example, during a recession the probability of investment loss will be high; while at the same time, the probability that the employer will not be able to fund the plan at the level expected will have increased.

The effect these risks will have on a plan's long-term funding requirements will depend on the maturity of the plan. Plan maturity is a nebulous concept, but it centers on how the plan has grown relative to the growth of the employer as well as how the plan has grown relative to itself. For example, have annual benefit distributions increased to the point where they exceed plan contributions (i.e., negative cash flow). The standard offers a number of measures of plan maturity that actuaries can employ along with the admonition that actuaries communicate the significance of any such measurement used.

At Findley, we are committed to proactively identify all risks that could significantly affect the future funded status and cost of our clients' plans. ASOP 51 may require additional actuarial risk analysis and reporting disclosures and formal presentations. ASOP 51 may require some changes to reporting and disclosures, but our commitment to our clients will remain unchanged.

Questions? Speak with the Findley consultant you normally work with or contact Ken Hohman at *ken.hohman@findley.com*, 502.253.4628, or Wes Wickenheiser at *wes.wickenheiser@findley.com*, 502.253.4625 .

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