

COMMENT #9: JANUARY 9, 2009

Comments in response to Request for Comments on Actuarial Standard of Practice (ASOP) Content and ASB Procedure

1. Appropriate level of guidance. There are a few areas which could be significantly improved in this important area.

- a. More than one level of guidance** – The ASB is currently set up to issue only one level of guidance, ASOPs. In many cases this limitation is not helpful to the development of good professional practices. My suggestion would be to broaden that viewpoint by providing more levels of guidance to provide actuaries with more useful guidance in many situations.

In particular, I suggest adding a level of guidance that would be “voluntary”, in that the actuary, or their principal, (or law/regulation) would specify that the particular standard would optionally apply to the actuary’s work. This would allow the actuary to use, or not use, a voluntary standard based on their choice, or their principal’s desires or requirements, based on the specific situation.

This would provide the actuary with a basis to offer certain services according to a specific voluntary standard. I am not at all advocating having voluntary standards in lieu of the current level (recommended standards). However, particularly where practice is developing or expanding, the availability of a voluntary standard could greatly assist the principal’s expectations about the actuary’s work products without needing customized requirements for each assignment.

Where there is a diversity of actuarial practice, having voluntary standards for some of the commonly used practices would be far preferable to having no standards at all. This approach would also allow an actuary to vary from a voluntary standard practice without the need to justify why they did not follow the standard.

Furthermore, as new actuarial practices are developed, there can be incremental “standardization” on a voluntary basis so that experience with such new practices can emerge without having to meet, or wait for, an ASOP covering such new practices. If such a voluntary practice standard became the “de facto” standard based on common usage, then a voluntary standard could be converted to a recommended standard of practice.

The issues around what is, or should be, “best practices” are mitigated somewhat by the use of voluntary standards. For example, some practice may be considered to be “best” by some, but getting a consensus by the profession can be quite difficult. By having a voluntary standard that provides guidance in such practices, the actuaries practicing in that area, and their principals, would have a standard to use by choice without imposing the standard on all actuaries. Another label that might be considered for such voluntary standards would be reference standards, meaning that actuaries can “refer” to them on an as needed basis.

While there might be concerns that voluntary standards could create problems with consistency, in reality the lack of any guidance is potentially a bigger problem for the profession. The other concern might be that some actuaries might disagree with a particular voluntary standard because it can be too easily become a “de facto” standard for actuaries. There are other solutions to this issue rather than avoidance. Multiple voluntary standards about a particular practice could be a viable solution. Another possible solution could be the creation of a hierarchical standard, as suggested below.

Another advantage of having voluntary standards is the ability to be much more specific in the guidance than is currently possible with ASOPs. The writing of an ASOP as a recommended practice can result extensive generalizations in order to have applicability to a wide variety of circumstances and diversity of practices. With a voluntary standard, the practice can be described in much more detail and such generalizations are less important because the standard would not place any requirements on the actuary.

The impact of voluntary standards would be to provide substantive practice guidance to an actuary that currently is limited to actuaries following methods written up in technical papers or following whatever methods seem to be commonly used by other actuaries whom they know or whose work they have access in a particular area of practice. Such informal approaches the development of common practice can have many issues. This is possibly one major reason why some actuaries have criticized the ASB for not advancing the state of actuarial practice. Common practice is not a sufficient condition for good or “best” practice. The profession is capable of a much better approach to developing practice guidance than depending on technical papers and common practices. Voluntary standards provide a means to improve the approach to better standards development.

There is an organization that has developed voluntary industrial standards for many years, ASTM. While the specifics of how ASTM develops such voluntary standards

would not easily fit the actuarial profession, there is a lot we can borrow from some of the elements to their approach to standards development.

Some areas where voluntary standards could be very useful would include predictive modeling in insurance rating, reserve margins, and ERM.

- b. Hierarchical Standards** – The currently level of guidance in ASOPs is generally one size fits all. There can be situations where actuarial practice is a balance between the depth of the analysis versus the time, effort and expense of performing the analysis. Also, the data used for the actuary’s analysis frequently have some issues which may be unresolved or the resolution of data issues is incomplete.

By structuring guidance in a hierarchy of methods or approaches, actuaries would have more flexibility in following the standard based on their particular situation. For example, a standard might provide a few levels of detail the actuary could follow from the basic level to more and more specific and detailed levels. Consequently, the actuary’s work product can comply with a certain hierarchical level and that level can be disclosed by the actuary without further qualifications.

- c. Types of Standards** - Another approach to standard setting that could be very helpful is to build actuarial standards as building blocks. These building blocks would start as a simple set of building blocks that can be used to support many other practice standards. The simple types would not be practice standards, but would include items that standards of practice depend on.

Standard terminology and standard definitions would be the basic level of such building blocks. Other building blocks could include standard tests, standard assumptions, standard models, etc. Another way of describing this approach would be actuarial testing standards, actuarial assumptions standards, actuarial model standards, etc. For example, there could be a standard for testing the past performance of an actuarial method or model, one for testing data used for certain types of actuarial analyses, or one for testing actuarial assumptions for consistency or other attributes.

Some examples of testing methods standards that come to mind as potential useful to practicing actuaries include methods for sensitivity testing, data testing, relationship (correlation) testing, stress testing, extreme event testing, and model testing.

- d. Principles** - At one time, prior to the development of ASOPs year ago, there was an effort to produce actuarial principles. It was thought that such principles would form

the underpinnings of actuarial standards. While some aspects of that concept do exist, there are concerns about the status of such principles in the future. In the case of the CAS, the CAS Board is moving in the direction of elimination their longstanding statements of principles, possibly replaced with more basis and fundamental statements that are not principles. The SOA Board has recently abandoned efforts to have any types of statements which would be considered actuarial principles. The American Academy has only the Statement of Actuarial Principles on Risk Classification. Furthermore, the development of principles-based standards is of great interest to insurance regulators and to financial reporting standard setters across many industries.

These developments have led to discussions as to whether the Academy, possibly through the ASB, should develop actuarial principles to provide the appropriate foundation for actuarial practice. The ASB type of process has been considered to be a more appropriate process for the development of actuarial principles than the current processes in place for the CAS and SOA. In other countries, those actuarial organizations who establish actuarial guidance are generally the national actuarial organizations, as in the case of the CIA in Canada.

The availability of “standard” actuarial principles, or actuarial principles for standards of practice, would be quite valuable for the profession. Since the CAS and SOA seem willing to have the ASB take over the promulgation of actuarial principles, and the need for such principles seems to be not only to take over any existing principles statements, but also to advance the profession by providing a level of guidance that is focused on actuarial principles, in addition to the standards of practice, either recommended or voluntary, which can be more directive of how the actuary should practice in a given area. Consequently, where an applicable ASOP does not exist, the actuary has a set of principles to refer to for guidance.

- 2. Degree of specificity in guidance.** While it is difficult to be prescriptive in many ASOPs due to the the range of acceptable actuarial practice, many ASOPs suffer from being worded in such general terms that the actuary may not be getting sufficient guidance from the ASOP as they might like to have, or that the users of actuarial work products might prefer. Many ASOPs are heavily worded with “should consider”, “should disclose”, “should document”, or should use their professional judgment”. This “wide open” approach is troublesome at times and can be very confusing, particularly without any guidance on “how an actuary should consider ...”, or what exactly is the basis for a professional judgment. These current wordings clearly assign the actuary a responsibility, but leave open how that responsibility should be carried out.

Some of the suggestions under #1 above could be used to provide more specific guidance, while at the same time not confining the actuary to a limited set of approaches. I don't see such guidance as being "prescriptive" unless such prescriptive guidance is chosen by the actuary or their principal for a particular assignment.

3. **Clarity of ASOPs.** Some of the current ASOPs do suffer, usually to a minor degree, from a lack of clarity or ambiguity. The use of examples would greatly enhance the ASOPs, but the ASB has seemed to have been reluctant to include examples due to concerns that the examples may be taken as prescriptive, or the examples may not appropriately cover the breadth of applicability of the ASOP. My suggestions under #1 provide a structure for providing more specific guidance in voluntary (or reference) standards. Where specific guidance is lacking, the availability of a set of actuarial principles would be very helpful to fill in the gaps.
4. **Exposure draft comment period.** The questions about the adequacy of the comment period fails to recognize the rapid pace that today's society expects to operate. This area of ASOP development is in need of a major overhaul in terms of making much better use of technology to expose concepts and ideas that are being considered for ASOPs before getting to the final wording. Emails and web-based discussions can work great for this purpose.

A more open drafting process via electronic means will certainly bring out issues more quickly and lead to a higher quality end product. If any actuary can sign up to be on an email list serve for ASOP drafting (or an online depository that sends email notifications when something has been added or changed), then the ASB committee or task force can use that system for distribution of outlines, interim sections, etc. This would make the process move along faster as issues are discovered more quickly than waiting for comments to discussion drafts or exposure drafts. In effect, this is an expansion of the occasionally used discussion draft approach which is in advance of the normal exposure draft process. It would also allow the committee or task force to solicit input or specific examples from those who are following the ASOP drafting, this enhancing the resources available to the drafters.

I am not advocating removing or changing the exposure draft comment period, but rather the suggested structure should accelerate the development of high quality guidance by addressing issues, questions and other input sooner in the process.

5. **Obtaining adequate number of representative comments.** See comments under #4 above.
6. **ASB responses to comments.** I think the ASB process can be improved in this area by using something that the IASB uses as part of their process. In addition to providing the final standard, they also provide a supplement called "Basis for Conclusions". The content of the

Basis for Conclusions is a description of various views, sometimes conflicting views, and a discussion of the Board's rationale that led to the final decision for the standard. This approach deals with the suggestions and objections that were submitted.

The summary of comments received and how each comments, or group of similar comments, could be reduced or eliminated if the essence is captured sufficiently in the "Basis for Conclusions" supplement. The process of considering comments might need to be expanded somewhat to provide a specific record of the consideration of the comments received. One way of achieving this record is to have the responsible ASB operating committee, subcommittee or task force vote on whether the comment or suggestion is persuasive or not, whether and what change were made, and have the actions noted in the minutes.

7. **Reliance under ASOPs.** The term "reliance" is not well understood and can be used inappropriately. Where an actuary is "disclaiming" responsibility with the rationale that the actuary has "relied" on others, then "reliance" is really a disclaimer of responsibility for certain assumptions, data, information, work of others, experts, etc. that are usually critical inputs into the actuary's work product.
8. **Concepts of other disciplines.** The concept of voluntary standards as discussion in #1 would be helpful in dealing with these issues as well. Where there are issues where ASOPs are not aligned with concepts from other disciplines, guidance can be provided in a voluntary standard dealing with a specific practice issue.
9. **Litigation risk.** The existence of ASOPs that say the actuary "should consider", "should use professional judgment", "should document", etc. can create some vulnerability to an actuary who does not have a record, or other evidence, of how they fulfilled such general "should" requirements in the ASOPs. There is a real need for actuaries to have some guidance that they can use to help them comply with the ASOPs, particularly where there are these general types of "shoulds". This is another area where the concept of voluntary standards, as discussion in #1, would be helpful as well.
10. **Other suggestions.** Another area of improvement that could be very helpful to actuaries is also borrowed from the IASB process. As a supplement to the standard, a detailed "Implementation Guidance" provides non-binding guidance via examples, charts, flowcharts or other useful assistance to the implementation of the standard. This would go a long way to helping improve actuarial practice without imposing more "shoulds" into the ASOP.

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January 9, 2009

