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ASB Comments – ASOP No. 6 Revisions
American Academy of Actuaries
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.6, *Measuring Retiree Group Benefits Obligations and Determining Retiree Group Benefits Plan Costs or Contributions*, as requested in the Exposure Draft of April 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 below, organized according to the questions listed on p. ix.

1. Is the level of guidance and educational content appropriate?

This is hard to answer, given the wide variety of experience levels that exist among readers of this ASOP. On p. vii you say "..because many actuaries are relatively new to this practice area." That wording was likely part of the original ASOP. Although it may still be true, there are also many actuaries who have been working in this area for 20 years or more.

In general, we would prefer that basic educational content–so long as it is readily available elsewhere to actuaries who want it–not reside in an ASOP.

2. Is the distinction among retiree group benefits plan, benefit plan, and optional benefits helpful to the actuary or not? Could it be further clarified?

Maybe, but the choice of terminology here is not standard by any means. You've chosen "benefits plan" for what we generally call "coverages" (with plans frequently containing multiple "coverages," such as medical, dental, prescription drug, vision, etc.). You've chosen "optional benefits" to refer to what we would generally call "benefit options" – two or more distinct choices presented to plan participants (e.g., PPO versus HMO, High Option versus Low Option). The word "plan" can, unfortunately, have different meanings depending on whether one is discussing accounting, DOL reporting, funding, or administration.

Throughout the ASOP, there are other terminology examples – e.g., "obligation" versus "liability" versus "present value of benefits" – where one concept has multiple names, or where one word is used for multiple concepts. The experienced practitioner is able to "read past the words" and discern the precise meaning from context. Inexperienced practitioners, however, may be very confused. For those situations where you feel that terms should be defined up-front, you need to ensure that a) you choose terms that are standard (to the extent possible) and b) you then use those terms consistently throughout the ASOP.

3. Is the revised guidance regarding the use of the "community-rated concept" appropriate? Are there any challenges that an actuary could encounter in deriving age-specific claims costs for employers participating in fully pooled health plans covering active participants and retirees? For those respondents who can do so, please provide specific examples of any challenges encountered in obtaining information from managers of pooled plans.

We feel that the topic here is really age-related costs and when to use them, not community rating *per se*. Therefore 3.7.7 and 3.7.8 could be replaced by one (or more) sections that would make the following key points:

- Certain welfare benefits demonstrate costs that vary, on average, with age, due to variations in the types of services utilized and/or the levels of utilization. For example, non-drug medical costs (before Medicare offsets) tend to rise with age. Dental costs tend to fall with age, as do prescription drug costs at advanced ages.

- In situations where these age-related benefits are being valued and changes in the average age of the group would be expected to affect the benefit cashflow materially, explicit recognition of this aging impact should be made via age-related per capita costs. The impact of aging generally should not be reflected implicitly through adjusted trend rates.

- For example, an uncapped employer obligation toward a self-insured medical plan covering a closed group of retirees should incorporate per capita costs that reflect expected variations in cost by age. Even if these retirees are pooled with active employees of the same employer for rate-setting purposes (e.g., to lend stability to contributions or for some other purpose), the underlying cost of the retirees should be reflected in the valuation, and costs should be age-related to reflect that fact that costs are expected to rise as the average age of the retiree group rises (above and beyond trend increases).

- On the other hand, coverage for a retiree group may be secured via a community-rated fully-insured plan, or through a pool that combines the experience of several employers (perhaps for active as well as retiree coverage). In these situations, costs may be expected to vary with the average age of the entire pool, but not directly with the average age of the employer's group alone. So long as the employer's own experience does not impact the premium rates paid for coverage, the aging of the employer's population alone does not impact the employer's cost, and age-related costs therefore are not appropriate for the valuation. However, to the extent that future aging of the entire pool is expected, the impact of such aging may be reflected in the valuation, if it could be reasonably estimated.

- In practice, note that plans which are referred to as community-rated are frequently still dependent on the individual group's demographics and/or past claims experience (e.g., "community rating by class"). It is important to assess the true nature of the pooling mechanism in order to select the proper aging treatment in the valuation model.

4. Are the changes to the standard to make it consistent with ASOP No. 4 appropriate?

We've included our comments on the ASOP 4 revisions (letter of 5/25/2012 from Aaron Weindling and William Turner) as an attachment to this letter. Consistency between the ASOPs is a worthy goal where the issues discussed are closely related (or identical).

5. Are there any other areas in which the guidance should be revised?

Miscellaneous comments and suggestions, by section number:

2.13: The reference to "participant's share of the annual claims cost" could also point to section 2.29, where that concept is given the name "participant contributions."

3.1, second paragraph: This discusses three distinct levels of actuarial involvement in method/assumption selection. To make that clear, we would append "without the actuary's advice" to the end of the final sentence.

3.4.2: We would question whether the phrase "..need not be reflected" ought to read… "..should not be reflected…". Or perhaps the real issue is that an actuary should reflect such events if he/she feels they are important to reflect, unless some external authority (law, accounting rule) directs him/her not to reflect them?

3.8, second paragraph: The section "..varies by age, but the insurance rates…" should read "varies by age, even though the insurance rates…"

3.9.2 c: "..actuary's prior expectations" should read "actuary's expectations" (we think).

p. 42, section "Measurements Using Premium Rates", last sentence of item 2: This may be true, but if the employer is actually charged that community-rated premium for its retirees, then no understatement is taking place in the valuation. (In other words, the premium, not the expected claim cost for retirees, is what the plan is actually paying.)

There may be an understatement in the long-run (as the average age of the "community" rises). So we would either strike this sentence or add clarifying words to it.

* * *

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

Sincerely,

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Attachment: 5/25/2012 letter from Towers Watson re ASOP 4 revisions