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ASB Comments
American Academy of Actuaries
1850 M Street NW, Suite 300
Washington, DC 20036

Re: ASOP 27 Exposure Draft

Dear ASB members:

This letter provides my comments on one narrow section of the ASOP 27 exposure draft. I recognize that you are receiving this submission beyond the comment deadline, but would nonetheless be grateful for your attention to the views presented. The views I present are my own, and do not necessarily represent the views of my employer. My comments relate to what is and to what is not an economic assumption.

As a preamble, I think that the proposed ASOP would be enhanced by including a definition of the term “economic assumption”. I usually tell my clients that an economic assumption is an assumption about the behavior of or properties of the economy as whole, whereas a demographic assumption is an assumption regarding things that happen to or are done by people.

Below is some text taken directly from the exposure draft, with bolding added. I will reference these items later in this letter.

2.4 Merit Scale—The rates of change in an individual’s compensation attributable to personal performance, promotion, seniority, or other individual factors.

3.2 Identifying Types of Economic Assumptions—the types of economic assumptions used to measure obligations under a defined benefit pension plan may include the following:

- a. inflation;
- b. investment return;
- c. discount rate;
- d. compensation scale; and
- e. other economic factors (for example, Social Security, cost-of-living adjustments, growth of individual account balances, and variable conversion factors).

3.8 Selecting a Compensation Scale—Compensation is a factor in determining participants’ benefits in many pension plans. Also, some actuarial cost methods take into account the present value of future compensation. Generally, a participant’s compensation will change over the long term in accordance with inflation, productivity growth, and merit scale. The assumption used to measure the anticipated year-to-year change in compensation is referred to as the *compensation scale*. It may be a single rate; alternatively, it may vary by age or service, consistent with the merit scale component; or it may vary over future years, consistent with the inflation component.

3.8.1 Data—The actuary should review available compensation data. These data may include the following:

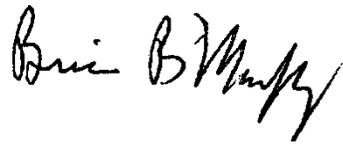
- a. the plan sponsor’s current compensation practice and any anticipated changes in this practice;
- b. current compensation distributions by age or service;
- c. historical compensation increases and practices of the plan sponsor and other plan sponsors in the same industry or geographic area; and
- d. historical national wage and productivity increases.

I have 3 suggestions regarding these items.

1. In the public sector where unfunded actuarial accrued liabilities are commonly funded as a % of payroll, the rate of payroll growth in the payroll is an explicit assumption. Often it is the sum of the rate of inflation and of productivity growth. I would like to see the **rate of payroll growth** listed as an explicit economic assumption in 3.2. This assumption is used primarily in public plans.
2. Because productivity growth is listed in 3.8 as a factor affecting the compensation scale and is clearly an economic factor. In my opinion it should be added to Item 3.2.
3. The compensation scale as discussed in 3.8 has s properties of both demographic and economic assumptions. I think it should be split into two separate assumptions, one of which we might call the base of the compensation scale. The base of the compensation scale is related to inflation, productivity growth, supply and demand in the labor market and other macroeconomic factors. In many cases it would be equal to the rate of payroll growth described above. The remaining portion of the compensation scale is the merit scale. All of the factors listed in 2.4 that affect the merit scale are individually based factors and do not relate to general economic performance. For this reason, I think that the merit scale is a demographic assumption, and that it should be classified as such. I would not expect to have to tabulate plan participate data based upon age and service as mentioned in 3.8.1.b in order to develop an economic assumption. I think the merit scale should be treated in ASOP 35, and only the “base” of the compensation scale should be treated in ASOP 27..

On a very practical basis, actuaries are likely to group assumptions that require tabulating member data into one section of an experience study, and assumptions that relate to broad economic performance into another section. From my point of view, it would be desirable if ASOP 27 and ASOPO 35 were in consonance with that very natural inclination and considered the merit scale to be a demographic assumption.

Sincerely,

A handwritten signature in black ink that reads "Brian B. Murphy". The signature is written in a cursive style with a large, stylized initial "B".

Brian B. Murphy F.S.A., E.A. M.A.A.A, F.C.A