Comment #5 – 4/25/11 – 7:54 p.m.

25 April 2011

ASOP No. 27 Revision
Actuarial Standards Board
1850 M Street, NW, Suite 300
Washington, DC 20036

Dear Actuarial Standards Board:

The Actuarial Standards Board (ASB) has issued a Request for Comments concerning ASOP No. 27, *Selection of Economic Assumptions for Measuring Pension Obligations*.

We thank the ASB for the opportunity to provide comments. Our comments address Questions 1, 2, 3, 7, and 8 of the Request.

1. Is the language in section 3.1 of ASOP No. 27, indicating that assumptions can be based either on the actuary's estimate of future experience or on the actuary's observation of the estimates inherent in financial market data, clear? Do you agree that either approach produces a reasonable assumption? If not, what change do you suggest?

   We agree that either approach might produce a reasonable assumption. On the other hand, either approach might produce an unreasonable assumption. It depends on the actuary's professional judgment and the definition of 'reasonable'.

   As with the material discussing various methods to support an investment return assumption in the current draft, we consider the discussion of the different data or approaches an actuary might use to develop a reasonable interest rate assumption to be 'educational'. Accordingly, we suggest that the second paragraph of section 3.1 be deleted and the discussion of the various approaches to set an assumption be added to a practice note.

2. Section 3 clarifies that there is no explicit link between an investment return assumption and discount rate. Does this create challenges for any existing actuarial processes? If so, please provide a description of the actuarial practice and how the new standard creates a problem. Is the removal of the material in section 3.6.2 of the current standard, which addresses the building-block method and the cash flow matching method, appropriate? Are the examples in section 3.7 of ASOP No. 27 sufficient to communicate the various purposes for which actuaries may need to choose a discount rate?

   We believe the discussion in section 3.6.2 of the current standard regarding approaches to consider in selecting an investment return assumption is useful and helpful to actuaries. We acknowledge that this discussion has educational elements and defer to the ASB regarding its placement in either the ASOP or a practice note.

However, since we believe this discussion is important and relevant to actuaries and to users of Statements of Actuarial Opinion, we are concerned if it is removed from the ASOP before a practice note is published.

Accordingly, at a minimum, we suggest the ASB be clear that the discussion is not being repudiated if it is removed from the ASOP. Preferably, though, we suggest that the discussion be retained until a practice note is published.

3. Do you agree that a reasonability standard is an appropriate way to set economic assumptions? If not, why not?

While we do expect that economic assumptions selected or recommended by an actuary would be reasonable, we are concerned that the standard as written is circular and does not provide sufficient specificity to allow an actuary to know, in advance, whether the selected assumption is reasonable or not.

In particular, we have the following comments:

The fifth sentence of the first paragraph of Section 3.1 does not define ‘professional judgment’ and does not allow for a process for actuaries with differing views to resolve those differences. More importantly, this language seems to suggest that challenging the reasonableness of an assumption is a challenge to the actuary’s professional judgment or even the actuary’s professionalism. Since actuaries are expected to be professional, we believe this sentence is redundant and suggest that it be struck. If this sentence is retained, we suggest that language similar to that in ASOP 41 (section 3.3.3) be added that introduces the concept that an independent actuary would agree that the professional judgment was well-informed.

The second paragraph of Section 3.1 discusses ‘reasonable’ in terms of ‘not anticipated to produce significant cumulative gains/losses’. This definition requires a judgment regarding the level of ‘anticipation’, the level of ‘significant’ and the time period over which to accumulate. For example, considering a stochastic analysis, would any result other than the mean be anticipated to produce some gain/loss? How do you measure significance? What if single year fluctuations are more disconcerting than cumulative gains/losses? While this definition seems attractive, we believe that it is ultimately circular and does not enable an actuary (or a user of a Statement of Actuarial Opinion) to assess *a priori* the reasonableness of an assumption. Furthermore, this measure of reasonable might mask the use of an inappropriate assumption (for example, using a non-economic assumption, an actuary might argue that an update to the mortality table is not necessary since the current assumption is not producing significant cumulative gains/losses).

While section 3.10 does require that each assumption be reasonable and section 3.11 does require that assumptions be consistent, there is no discussion of the aggregation of the assumptions. For example, if each individual assumption was just barely, on its own, not anticipated to produce significant cumulative gains/losses), could the same be said for the aggregation of all of the assumptions? We suggest that the reasonableness of the entire assumption set be discussed in the ASOP.

It is not clear what time horizon the actuary would consider in developing an economic assumption. Section 3.6 discusses the ‘measurement period’ as if it is the time horizon, yet for some purposes (such as the Expected Return component of pension expense) the ‘measurement period’ (as defined in Section 3.2) is considerably shorter than the time horizon used to develop a long-term rate of return assumption. Accordingly, we suggest that references to ‘measurement period’ be replaced with references to a ‘time horizon’. In this case, some discussion of an appropriate time horizon would be helpful. In any case, we suggest that section 3.6(h) be expanded to include the expected exhaustion of current trust assets as an appropriate end to the time horizon.

7. Do you agree that it may be appropriate for the actuary to include conservatism in his or her assumptions? Are the disclosure requirements for a conservative assumption sufficient?

We do not believe that an adjustment for ‘conservatism’ is necessarily reasonable. While the term does suggest some incremental cushion against adverse experience, not all actuaries, principals, users or other third-parties (such as plan participants) perceive risk similarly. In some cases, an adjustment for conservatism might reduce the risk for one class of users (or participants) while increasing the risk for others. Or, in some cases a lower discount rate might be considered conservative (since it is increasing the liabilities on the balance sheet); in others it might be aggressive (if it results in increased rates charged by a utility).

We are further concerned that such an adjustment might be seen as weakening the otherwise reasonableness of an assumption. In other words, if before adjustment, the assumption was marginally reasonable, would the adjustment for conservatism result in an otherwise unreasonable assumption?

We believe that the ‘reasonable’ concept is broad enough to allow an appropriate degree of conservatism (or aggressiveness), and that an explicit degree of conservatism is not appropriate.

8. Do you agree it is appropriate to require the actuary to provide rationale for assumptions or changes in assumptions? If so, do you agree that the proposed changes represent the appropriate approach?

   We believe that it is important for an actuary to select assumptions with due care and to be prepared to discuss the factors considered. Accordingly we support the desire to provide at least a brief discussion of the factors considered in selecting the assumption. In this context, we would expect that the actuary would be cooperative if the client or other users of the Statement of Actuarial Opinion requests further detail.

While not specifically addressed in the questions, we would also like to comment on the scope of ASOP 27. This exposure draft continues current practice of providing distinct – and potentially divergent – guidance regarding pension measurements and opeb measurements.

Many actuaries work with clients who maintain both pension plans and retiree group benefit plans. Actuaries currently have disparate guidance for their work on pension plans when compared to guidance for their work on retiree group benefit plans. Accordingly, we believe that it would be helpful to actuaries to have a single ASOP focused on all economic assumptions used in both pension and retiree group benefit measurements. We suggest that the guidance currently in ASOP 6, *Measuring Retiree Group Benefit Obligations,* regarding certain non-pension economic assumptions be moved to ASOP 27, which could then be retitled as *Selection of Economic Assumptions for Measuring Retirement Benefits.*

Currently, ASOP 27 is focused solely on economic assumptions used in measuring pension obligations (cf. section 1.2). However, section 3.8.1 of ASOP 6 does direct an actuary to the guidance of ASOP 27 when selecting certain (but not all) economic assumptions used in the measurement of retiree group benefit obligations, thereby creating a conflict between section 1.2 of ASOP 27 and section 3.8.1 of ASOP 6. For example, an actuary considering the interest assumption for a retiree medical plan would look first to Section 3.8.1 of ASOP 6, which refers the actuary to ASOP 27, which in turn refers the actuary to ASOP 4.

Section 1.2 of ASOP 27 also provides that, in case of conflict with ASOP 4, that ASOP 4 will govern. There is no such hierarchy of ASOPs between ASOP 6 and ASOP 27, or between ASOP 4 and ASOP 6.

A single ASOP focused on all economic assumptions used in both pension and retiree group benefit measurements would be helpful to actuaries by eliminating the cross-references between ASOPs and clarifying the relationship between ASOP 6 and ASOP 27.

Finally, we note that the exposure draft uses ‘significant/significantly’ and ‘material/materially’ without defining those terms.

> Many users of Statements of Actuarial Opinion, particularly auditors, consider those terms to have very specific meaning. Actuaries may have different understanding of those terms. For example, an actuary may consider a 0.1% change in the benefit obligation to be ‘immaterial’; however, depending on the relationship of the benefit obligation to a company’s financial statements, an auditor might consider the same amount to be very ‘material’. Accordingly, we suggest that the terms be defined so that both actuaries and users of Statements of Actuarial Opinion have a common understanding of what is meant.

We acknowledge the effort of the Actuarial Standards Board in updating ASOP No. 27, and thank them for the opportunity to provide comments. We would be pleased to discuss any of these comments in person, if they feel it would be helpful.

We are providing these comments as individual experienced consulting actuaries and not on behalf of our employer or any other organization.

Sincerely,

John T. Stokesbury

Ira G. Kastrinsky

Howard A. Freidin