TOWERS WATSON

8400 Normandale Lake Boulevard
Suite 1700
Minneapolis, MN 55437-3837

T +1 952 842 7000
F +1 952 842 7001

towerswatson.com

April 28, 2011

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

Dear Sir or Madam:

This letter is the response of Towers Watson to the Proposed Revision of Actuarial Standard of Practice (ASOP) No. 27, Selection of Economic Assumptions for Measuring Pension Obligations, as requested in the Exposure Draft of January 2011. Towers Watson is a global human capital and financial management consulting firm specializing in employee benefits, human capital strategies, and technology solutions. Established on January 1, 2010 as a combination of the former Watson Wyatt and Towers Perrin, 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 on the ASOP 27 Exposure Draft generally follow four central themes that we firmly believe should apply to all of the ASOPs:

- 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 or seek to substitute rules for the actuary's reasonable professional judgment.

- The ASOPs should set forth minimum professional standards as opposed to best practices. Because 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 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 an 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 the work only for our client and no other person or entity can expect to rely on our work. We strongly believe any ASOP that explicitly provides for or allows a presumption that actuaries perform work for the general public will have only one result - exposing actuaries to unwarranted and unmanageable risk.

TOWERS WATSON

Our specific comments on the Exposure Draft reflect these basic principles, and are outlined below.

Section 1.1 Purpose. We support the removal of paragraph 1.1(c) from the Purpose section and agree that enhancing non-actuaries' understanding is not an appropriate purpose of an ASOP.

Section 1.4 Effective Date. We believe the specified effective date is impractical because it is generally not clear when an actuarial work product is "produced." Reasonable interpretations could fall in a range extending from the date at which assumptions are selected and valuation systems are programmed, to the date when a final actuarial report is delivered to the Principal. Because the production process often spans a number of months, there will be uncertainty about whether or not the revised ASOP applies in a given situation. We note that the existing standard has an effective date based on a measurement date rather than a production date, and we do not support changing this approach.

With regard to the lead time of four months, we believe that the magnitude of the changes is significant and will require modifications to valuation systems and reports. Such changes take time to plan and execute and are typically done on an annual cycle. We suggest that the effective date be for measurements on or after the January 1 coincident with or following six months after adoption.

Section 3.1 Overview. We are in general agreement with the move from a best-estimate range concept to a reasonable assumption standard. However, we have a few comments on the specifics of this section:

- The ASOP should clarify that the reasonable assumption standard is not a single-point best estimate standard, and that two different assumptions may both be considered reasonable, even if used by the same actuary in somewhat similar situations. The transmittal memorandum to the Exposure Draft discusses this point, but we believe it would be helpful to include a similar clarification in the ASOP itself.

- The Exposure Draft states 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. However, there may be some measurements for which a reasonable assumption would be based on a combination of the two. The ASOP should explicitly allow for such applications, and Section 4.1.1 on disclosures should be modified accordingly as well.

- An estimate inherent in financial market data will often be a combination of directly observed market data and other factors, such as an estimated risk premium. When basing an assumption on market observations, the actuary should be permitted to adjust the assumption for such factors in the financial market data that should not be included as part of the assumption.

  As an example, consider breakeven inflation. This is the difference between the yields of nominal and inflation-indexed fixed income securities with the same maturity. Although it sheds light on market participants' expectations of future inflation, it represents more than this single component. Breakeven inflation consists of several factors, including inflation expectations, an inflation risk premium and a liquidity premium. It would be appropriate to include only the first element when projecting pension benefits and calculating the related obligation. An observed value of breakeven inflation could be adjusted to exclude the estimates of the unwanted components. Therefore, we suggest modifying the last sentence of section 3.1 to specifically allow for such adjustments to market data.

Section 3.6 Selecting an Investment Return Assumption. The ASOP states that the investment return assumption reflects the anticipated returns on the plan's current and future assets. However, depending on the purpose of the measurement, an investment return assumption might be based on the anticipated returns on the plan's current assets only. We suggest that the wording of this section be modified to say "The investment return assumption reflects the anticipated returns on the plan's current and, if appropriate to the purpose of the measurement, future assets."

TOWERS WATSON

Section 3.6.3(c) Investment Volatility. In our view, it is inappropriate for the ASOP to list as a consideration in constructing an investment return assumption that plans may be required to liquidate certain assets at depressed values to meet benefit obligations. We believe that the amount for which an asset could be sold is its value. A judgment about whether this value might at some future time be anomalously "depressed" is not relevant to the selection of economic assumptions. In addition, whether a plan liquidates or holds an asset is irrelevant to the investment return assumption because the market value will be the same in either case. These are issues that a plan sponsor might consider in setting the investment policy but, once decided, are not relevant to the investment return assumption. In addition to modifying section 3.6.3(c), we also suggest deleting the last sentence of section 3.6.3(g) for these same reasons.

Section 3.6.3(j) Arithmetic versus Geometric Return. The transmittal memorandum notes that the use of assumptions based on either arithmetic or geometric returns may be appropriate depending on the purpose of the measurement. However, the Exposure Draft states that a geometric return used "either by itself or in combination with an arithmetic return" is reasonable. We believe that an assumption based on the arithmetic average of simulated future returns is equally reasonable. Depending on the purpose of the measurement, one might be preferable to the other but either approach is generally reasonable. The language of the ASOP should accommodate this by stating, for example: "Depending on the purpose of the measurement, the use of an investment return assumption based on either a geometric return or an arithmetic return, or a combination of the two, may be reasonable."

Section 3.8 Selecting a Compensation Scale. The ASOP states that the compensation scale may vary by age or service, consistent with the merit scale component; or it may vary over future years, consistent with the inflation component. The words "consistent with the merit scale component" and "consistent with the inflation component" are overly restrictive and should be deleted. Alternatively, the words "for example" should be added. There are numerous appropriate rationales for varying assumed compensation increase rates in ways that are not consistent with either the merit scale or inflation, many of which are discussed in section 3.8.2. Examples include temporary pay freezes resulting from a contraction in the plan sponsor's business, the plan sponsor's efforts to realign compensation levels with market prevalence, and scheduled increases contained in collective bargaining agreements.

Section 3.8.2(d) Compensation Volatility. We suggest changing the phrase "this may be accomplished" to "this might be accomplished." We believe the word "might" better conveys the idea that this is one possible option among many, rather than a preferred or prescribed approach. This observation is generally applicable to the entire standard, and we suggest that the Pension Committee review all passages with this comment in mind.

Section 3.11 Consistency among Economic Assumptions Selected by the Actuary. We agree with the statement in this section that each economic assumption selected by the actuary should generally be consistent with every other economic assumption selected by the actuary for a particular measurement. However, the discussion throughout the rest of this section appears to emphasize the inflation component exclusively and ignores the issue of consistency that may relate to other economic factors. We believe it would be appropriate to also mention that there should be some degree of consistency between other components of the actuary's assumptions, for example between the assumed equity risk premium and the productivity growth component of the compensation scale, since both relate to a presumption about the level of economic growth. We also suggest deleting the last sentence of the first paragraph, as its meaning is unclear and it appears to be inconsistent with the rest of this section.

Section 3.15.1 Conservatism. We agree that it may be appropriate for the actuary to include a provision for conservatism in his or her assumptions. We would also stress that conservatism should not be required within actuarial measurements. This is consistent with the draft language. Unless there is an explicit disclosure by the actuary in accordance with section 4.1.1, it should be understood that the assumptions have not been adjusted to provide conservatism. We suggest including a statement to this effect in this section.

TOWERS WATSON

<u>Section 3.15.3 Cost Effectiveness</u>. The ASOP states that the actuary should establish a balance between refined methodology and cost effectiveness. We suggest replacing the word “should” with “may,” because this balance will typically be established by the Principal in the terms of the engagement with the actuary. While we agree that cost effectiveness is desirable in most cases, there may be rare circumstances where the Principal specifically requests that a refined measurement be determined regardless of cost considerations. It should not represent a deviation from the standard for the actuary to provide it.

<u>Section 3.15.5 Subsequent Events</u>. We suggest deleting the words “that is unique to a plan or plan sponsor” from this section. In some situations and depending on the purpose of the measurement, it might be appropriate to reflect an event occurring after the measurement date that is not unique to the plan or plan sponsor, such as a market downturn or a significant change in interest rates. The current language of the ASOP precludes the actuary from doing so without deviating from the standard.

<u>Sections 4.1.2 and 4.1.3 Rationale for Assumptions and Changes in Assumptions</u>. We oppose the significant expansion of the disclosure requirements as proposed in the Exposure Draft. While we agree that describing the rationale behind assumptions and changes in assumptions may be considered a best practice in many situations, it is inappropriate for the ASOP to require these disclosures. The requirement for such disclosures could interfere with the actuary’s contractual arrangement with the Principal, as the rationale for changes in certain assumptions (such as compensation, termination, or retirement rates, for example) may be based on confidential business plans that the Principal would not want disclosed. In addition, these new disclosures will often involve substantial additional work that is not requested by the Principal and for which the actuary will likely not be compensated. The transmittal memorandum states that “the Pension Committee believes this disclosure requirement will improve the communication to end-users of the actuarial work.” If the Principal would like this disclosure then he or she may request it of the actuary. If the requirement is intended to benefit other “end-users” then we believe this is inappropriate. The actuary’s obligation is to the Principal, and the ASOP should not impose additional burdens for the benefit of other parties.

<u>Section 4.1.4 Changes in Circumstances</u>. In our view, this section is unreasonable and should be deleted in its entirety. It is an overreach to require disclosure of significant events occurring after the measurement date along with their likely effects. The only post-measurement date events for which disclosure should be required are those that have actually been reflected in the measurement. While the disclosures described in section 4.1.4 might be considered a best practice in some circumstances, it is inappropriate for the ASOP to require them. In addition, the requirement to describe “the likely effect of any such change” will often involve significant additional work that is outside the scope of the engagement and is not requested by the Principal. This is an inappropriate intrusion into the terms of the engagement between the actuary and his or her Principal.

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

Sincerely,

William H. Turner

Aaron Weindling

William H. Turner, FSA, EA, FCA
Senior Consulting Actuary
952 842 6679

Aaron R. Weindling, FSA, EA, MAAA, FCA
Senior Consulting Actuary
215 246 7041