



Comments on the Third Exposure Draft of the Proposed Actuarial Standard of Practice on Modeling

October 31, 2016

The Actuarial Standards Board

The ASPPA College of Pension Actuaries (ACOPA) appreciate this opportunity to comment on the Third Exposure Draft of the Proposed Actuarial Standard of Practice on Modeling (Modeling ASOP). ACOPA's comments are prepared by actuaries who work primarily on small to mid-sized pension plans, including plans in which a significant portion of the pension obligation is attributable to principal employees.

ACOPA appreciates the consideration the Actuarial Standards Board (ASB) Pension Committee gave to comments we submitted in May, 2015 on the previous exposure draft. However, we remain concerned that the scope of this proposed standard remains unclear. Section 3.1 of the proposed Modeling ASOP applies only if the model is not a "simple model" and "in the actuary's professional judgment" the results are "heavily relied on by the intended user" *and* have a "material financial effect". The ambiguity arises because:

- The definition of "model" is overly broad. ACOPA commends the addition of the concept of a simple model being exempt from the requirements of the proposed Modeling ASOP, but the definition of "simple model" is unclear. In fact, we have struggled to understand what models were contemplated by the definition.
- It is not clear what the standard is for "heavy" reliance. For example, for a non-governmental single employer defined benefit pension plan, a minimum required contribution under Internal Revenue Code section 430 is a required determination that must be certified by the actuary. Since there is one number certified by one actuary, does that mean reliance is "heavy"?
- The actuary may not know if the financial effect is "material". ASOP 1 section 2.6 states that materiality is based on whether or not "omission or misstatement could influence a decision of an intended user", and goes on to say that in some situations "materiality will be determined by an external user, such as an auditor, based on information not known to the actuary".

ACOPA recommends the following to address these ambiguities:

- Examples of models that are intended to be covered and not covered by the proposed Modeling ASOP would be useful in understanding the intended scope. At a minimum, the definition of model in section 2.7 should be modified to make it clear that "model" does not generally include individual benefit calculations, individual benefit estimates or

nondiscrimination testing of benefit plans. Language to this effect is already included in section 1.2 of ASOPs 27 and 35. The following statement would be consistent with these pension ASOPs: “A model does not generally include individual benefit calculations, individual benefit estimates or nondiscrimination testing.”

- “Simple model” is defined (in section 2.12) as a model with transparent results that can be predicted without actually running the model, or that can be “readily obtained from an external source that is not a model”. It is not clear what “actuarial service” fits that definition unless the intention is that “predicted” does not refer to a numerical output, or refers to a reasonable estimate of the results. ACOPA recommends that the definition be expanded to make it clear as to whether or not the result is a numerical result, and if so, if the estimate would be identical to the output of an actual run. ACOPA also recommends that examples of a simple model be provided to assist in understanding the concept.
- ACOPA recommends that a statement be added to section 3.1 of the proposed Modeling ASOP indicating that heavy reliance should be assumed where the output is required for governmental or financial reporting purposes and, to the actuary’s knowledge, the results provided to the intended user will be used to satisfy that requirement.
- Since an actuary may be unable to determine if the results of the model are material to the intended user, section 3.1 should be modified to address that possibility. ACOPA recommends that a statement be added to the third paragraph of section 3.1 of the proposed Modeling ASOP such as “In the absence of other information to the contrary, the actuary may assume a result that is a small percentage of a related data point (such as compensation for a benefit cost) is not material.”

Section 3.9 of the proposed Modeling ASOP states that if another applicable ASOP includes “specific” guidance that conflicts with guidance in the proposed Modeling ASOP, the guidance of the other ASOP governs. Although this provides a path to resolving conflict, eliminating the perception of conflict where none is intended would improve compliance. ACOPA suggests the following clarifications to conform the proposed Modeling ASOP to other ASOPs applicable to pension work without changing the intent of the guidance:

- **Assumption Prescribed by Law Definition** - The proposed Modeling ASOP does not define an assumption prescribed by law but it discusses such an assumption. In the proposed Modeling ASOP, an assumption chosen by law is any legally binding assumption. ASOP 4 section 2.21 explicitly defines Assumption Prescribed by Law and states that an assumption chosen by a governmental entity with respect to its own pension plan shall not be considered an Assumption Prescribed by Law. Thus, an actuary working in the public pension area could be faced with two different meanings of the term “Assumption Prescribed By Law”.

This issue already exists with ASOP 41 because ASOP 41 uses the approach in the proposed Modeling ASOP. However, the proposed Modeling ASOP compounds the issue because section 3.4.7d provides a different requirement to dealing with potentially inconsistent assumptions for assumptions prescribed by other and assumptions prescribed by law.

ACOPA recommends that definitions be added to the proposed Modeling ASOP for “Assumptions and Methods Prescribed by Law” and” Assumptions and Methods Prescribed by another Party” and for work subject to ASOP 4 that the definition conform exactly to the definition in ASOP 4.

- **Future Expectations in Setting Assumptions** – Section 3.4.7 of the proposed Modeling ASOP discusses how assumptions should be chosen for a model. The discussion emphasizes experience without reference to future expectations. ASOP 27 3.6d and ASOP 35 section 3.3.5d require that for an assumption to be reasonable that it not only be based upon relevant experience, but the assumption either represent the actuary’s future expectations, estimates inherent in market data or a combination of both.

It is not that ASOP 27 and ASOP 35 are more specific than the proposed Modeling ASOP. Instead, the issue is that ASOPs 27 and 35 describe a fundamentally different approach for choosing assumptions than the proposed Modeling ASOP. This is potentially confusing for an actuary when an assignment is subject to both ASOPs.

ACOPA recommends that 3.4.7 be updated to reflect that for work subject to ASOP 27 and/or ASOP 35 that as appropriate for the intended purpose the assumption should either represent the actuary’s future expectations, estimates inherent in market data or a combination of both.

- **Confidentiality** – ASOPs 4, 27 and 35 have an explicit statement that these ASOPs are not intended to require the disclosure of confidential information. The proposed Modeling ASOP does not contain such a statement.

ACOPA recommends a confidentiality provision be added to the proposed Modeling ASOP.

This letter was prepared by a task force of ACOPA’s Professionalism Committee, chaired by Lynn M. Young, MSPA. If you have any questions, please contact Judy Miller, Executive Director of ACOPA, at (703) 516-9300 ext. 152 or jmiller@usaretirement.org.

Thank you for your consideration of these comments.

Sincerely

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