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July 31, 2018

Subject: Comments on Proposed Revisions to ASOP 4, 27, and 25

Mercer is pleased to provide our response to exposure drafts of the proposed revisions to ASOPs 4, 27, and 35. These comments were prepared by Mercer's Actuarial Resource Network, a group of senior actuaries in the retirement practice area representing all of the U.S. geographic areas in which Mercer operates.

As these proposed ASOPs are somewhat related, to avoid duplication we are providing one consolidated comment letter. In general we are supportive of the direction being taken and appreciate all the efforts expended. However, we would offer the following comments (references to ASOPs are, unless otherwise indicated, references to the exposure drafts):

Section 3.6.3 of ASOP 27 and Section 3.4 of ASOP 35—Phase-in of Changes in Assumptions.
We believe that if the ASOP is going to discuss phase-in, a more in-depth discussion is needed, as in many cases a phase-in would seem to be inappropriate actuarial practice. If the party selecting an assumption has decided to phase it in, then there must be some underlying purpose behind this decision. If the assumptions at each step of the phase-in are reasonable, then there seems to be no reason to implement the phase-in unless (a) the party setting the assumption believes that the ultimate assumption is a better assumption than the intermediate assumptions or (b) the phase-in is an explicit attempt to achieve some smoothing. If the former applies, then we are troubled by the idea of deliberately using something that falls short of an acknowledged best estimate. If the latter applies, then it should only be done if the rules regarding that particular measurement permit it (e.g., if some public sector jurisdiction allow assumption changes to be phased in in order to achieve smoothing). In either case, at the very least, any phase-in should be explicitly identified and rationale should be provided. Of course, each step of the phase-in must still also be reasonable (unless the applicable rulebook permits an assumption not to be reasonable during the phase-in period, in which case the actuary should indicate a lack of reasonability).

Section 3.5.3(a) of ASOP 35
We do not believe this sentence is appropriate as written. While we acknowledge that the stem only says "should consider," a non-actuary could easily be left with the impression that generally available mortality tables are necessarily better than other tables, including tables developed based on a plan's own credible experience, when in fact, a table that has considered a plan's own experience will often be a more

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appropriate assumption. We suggest appending the current sentence with "when tables which are more reflective of the plan's actual experience are not available."

Section 4.1.2 of ASOP 35—Rationale for Assumptions

The second paragraph of this section requires rationale for using a mortality table substantially older than current relevant tables. We have three comments on this:

1. As noted in our comment on Section 3.5.3(a), plan-specific tables can be more relevant than general tables. Rather than hinting at the opposite, we suggest comparing apples to apples by inserting "published" after "based on."

2. Other than the point raised immediately above, we agree with the requirement to provide rationale when it comes to healthy lives mortality. However, we are not convinced this is an appropriate requirement, at least at this time, for disabled life mortality. None of the recently published choices for disabled life mortality tables is necessarily appropriate for a given population, as the recent tables do not tie to a specific definition of disability. In fact, RPEC itself noted the limitations of the data (and thus the results) used to prepare the disabled life mortality table associated with RP-2014. Yet someone less schooled in the nuances of disabled life mortality could conclude that because RP-2014 is (by far) the most recent table, an actuary not using it would be doing something improper, when in fact it may be more reasonable to use an older table with appropriate projection. In short, we don't believe that pension actuarial practice has evolved to the point where the requirement to "justify" the use of an older table (as opposed to the general rationale requirement that applies to any significant assumption) should apply to disabled life mortality.

3. We note that as the section is written, the reference to "significant assumption" is only applicable to paragraph 1, not this paragraph, meaning that one could read this as requiring the actuary to justify or disclose the rationale for using an older table even when mortality (or disabled mortality) is not a significant assumption.

Section 3.13 of ASOP 27 and Section 3.8 of ASOP 35

The penultimate sentence in each of these sections has the words "as appropriate." Although we acknowledge these words have simply been held over from the current version, we're unclear as to their purpose. They seem to suggest that if the previously selected assumptions are not reasonable, the actuary can choose whether to select new ones that are. We suggest striking the words "as appropriate."

Section 4.1.2 of ASOP 27, Section 4.1.2 of ASOP 35, and section 4.1(l) of ASOP 4.

These sections are all interrelated. While we are comfortable with what we believe to be the intent of the authors, we expect the new requirements will be confusing to all but the most discerning of ASOP readers.

The current ASOPs do not require an actuary to certify that an assumption is reasonable, only to state it if is not, or cannot be evaluated. One reason for that is the somewhat confusing language in the current ASOPs that acknowledges two different approaches to evaluating reasonableness: one for assumptions selected by the actuary, and another for assumptions set by another party, which must be evaluated for reasonableness to meet the disclosure requirement of Section 4.2 of each of these ASOPs and Section 4.1(l) of ASOP 4. . For shorthand here, we refer to that second usage as determining if an assumption is not unreasonable.

The proposed ASOPs would require that an actuary provide rationale as to how a prescribed assumption was determined to be reasonable (i.e., not to be unreasonable). However, that does not mean that the actuary would consider the assumption to be reasonable if the actuary were selecting the assumption. As modified, though, section 4.1(l) of ASOP 4 would now require that the actuary opine that assumptions (individually and in the aggregate) are reasonable, including assumptions selected by another party. Doing so would require that either the actuary apply two different standards of reasonableness in 4.1(l) depending on whether it's the actuary's assumption or one set by another party, or come to the conclusion that the assumption set by the other party is indeed the assumption the actuary would have selected. We don't believe the latter was intended—it would be a mammoth change in guidance and inconsistent with the guidance in 4.2(a). However, the allowance for two different approaches to assessing reasonability, depending on who set the assumption, could result in readers of the actuarial report erroneously concluding that the narrower standard of reasonability applicable to assumptions selected by the actuary was applied in making the statement required by 4.1(l) of ASOP 4. We therefore believe that when some of the assumptions are set by another party, the disclosure requirement applicable to the collection of assumptions should parallel the requirement applicable to the assumptions individually, requiring only that the actuary disclose when the assumptions collectively significantly conflict with what the actuary believes to be reasonable or were not evaluated for reasonableness.

Section 3.12 of ASOP 27, Section 3.7 of ASOP 35, and section 4.1(l) of ASOP 4. (Consistency of assumptions)

The current ASOPs indicate that the actuary should select assumptions that are consistent with *other assumptions selected by the actuary,* and current ASOP 27 indicates that economic assumptions selected by the actuary need not be consistent with prescribed assumptions. The exposure drafts kept the former language, deleted the latter language, and then incorporated a requirement in 4.1(l) of ASOP 4 that the actuary certify that all assumptions, including prescribed assumptions not set by law, be consistent. Perhaps an actuary could certify that the prescribed assumption was not inconsistent, but the actuary may not be able to determine whether the set of assumptions are consistent with an assumption that the actuary didn't set. Regardless, requiring any kind of opinion that includes consistency of prescribed assumptions not set by law is a subtle change in wording that creates a very significant change in practice for most pension actuaries and thus it needs to be highlighted.

Section 2.18 of ASOP 4—Output Smoothing Method
Clarifying that “phasing in the impact of assumption changes on contributions” is not the same as phasing in the assumptions themselves might be worthwhile.

Section 3.3 of ASOP 4—Purpose of the Measurement
From purely a readability perspective, placing 3.3.1 immediately following a list seems awkward and perhaps inconsistent with normal ASOP structure.

Section 3.10 and 3.11 of ASOP 4
These two sections seem somewhat inconsistent. Section 3.10 is a pared-down version of a much longer section included in a previous exposure draft that was not included in the final statement. To an extent, Section 3.11 reinstates parts, but not all, of the previously exposed 3.10. Presumably, 3.11 describes a subset of 3.10, i.e., the investment risk defeasement measure is a market consistent present value. (Whether section 3.10 is still necessary is necessary if section 3.11 is ultimately included is debatable.) Regardless, section 3.11 should be consistent with 3.10. We noted a few issues:

1. Section 3.10 includes the phrase “the actuary’s observation of the estimates inherent in market data” because in any model involving yields estimates are involved. There is no one market yield for a given time period. However, 3.11 simply says “market yields”. We believe the “estimates inherent” language is more appropriate, but regardless, we think using different terminology for what is essentially the same thing is confusing.

2. Similarly, 3.10 says “benefits earned,” while section 3.11 says “benefits accrued.” If those two are meant to mean something different, the meaning of each should be clarified. If they are not meant to be different, then we believe consistent terminology should be used.

3. Section 3.11(b) indicates the unit credit cost method should be used. However when it comes to items such as subsidized early retirement, subsidized benefit options such as a social security leveler, and any other benefits triggered by completion of an age requirement, unit credit is not universally defined. Prior Boards (and Pension Committees) struggled with this and the difficulty in developing a consistent definition was a factor in the decision to use the shorter version of 3.10. If the Board is expecting Section 3.11 to produce a consistent definition, the ASOP needs a more thorough description of the cost method. If that is not the Board’s intent, then perhaps changing it to “*a* unit credit cost method” would be appropriate.

Section 3.11 of ASOP 4
Comments were requested as to the appropriateness of the two choices for determining discount rates. We have the following comments:

1. If the plan being valued is not a U.S. plan, does not pay benefits in U.S .dollars, and assets are not invested in the U.S., we don't believe that U.S. Treasuries are an appropriate benchmark. For such plans, yields of fixed income securities would logically be based on securities of the country in which the benefits are denominated. However the vast majority of those countries have do not have a fixed income market that includes enough bonds of sufficient term to construct a curve or determine an appropriate discount rate. This is an issue that the IASB has struggled with for years, with seemingly no good solution. We have no answer either other than potentially to limit the scope of section 3.11 to exclude these types of plans.

2. Studies have shown that the number of AAA bonds has plummeted since the SEC first issued their "one of the two highest ratings" guidance which appears to be the basis for this section. So for practical purposes one would conclude that the two highest ratings are AA and A, but since there are still a few AAA bonds, that would not seem to comply with the letter of the requirement. Studies have also seemed to demonstrate that the requirements for attaining an AA rating have risen since the SEC issuance. We do not believe that allowing the use of all bonds rated A, AA or AAA would result in misleading readers, and might alleviate the practical issues associated with just using AA and AAA.

More fundamentally, for plans where cash flows are not fixed, but rather vary based on changes in economic conditions, simply discounting projected cash flows using market bond yields will likely produce a value that is not a market-consistent present value and therefore would introduce an unintended conflict between 3.10 and 3.11. These include variable annuity plans and other risk-sharing designs as well as plans that pay variable lump sums. We suggest that the 3.11 be revised to allow for a principle-based approach, or that the strict requirement to use market bond yields be otherwise limited to situations where doing so would not produce a conflict with 3.10.

Section 3.16 of ASOP 4—Output Smoothing Method

We believe the disclosure of the result with and without output smoothing would be useful and not difficult to obtain. We therefore suggest adding this item to the required disclosures when using output smoothing.

Section 3.17 of ASOP 4—Allocation Procedure

We have concerns about three aspects of this section:

1. We are not sure how to consider benefit security in developing an allocation procedure, except for the obvious fact that the more money is in the trust, the more secure the benefits will be. Of course, for an employer in difficult financial straits, larger contributions may eliminate job positions and loss of nonvested benefits. But exactly how would an actuary reflect that in selecting a contribution allocation policy?

2. "Intergenerational equity" is a very popular term, but if an actuary is going to be held to having considered it, we believe it should be defined in a useful way. And given that "equity" is here a synonym for "fairness," and fairness is always in the eye of the beholder, suggesting in section 4.1(w) that an actuary should disclose essentially a definition of fairness that is pertinent to the plan seems impossible.

3. We acknowledge that the balance described in 3.17(d) is important, albeit very difficult to define, and would be comfortable eliminating a-c and rewriting d to say a balance between benefit security, intergenerational equity, and stability etc. However, for some of the same reasons, we believe that it will be extremely difficult to provide any sort of coherent rationale for that balance as required by 4.1(w). We suggest removing this requirement.

Section 3.20 of ASOP 4—Reasonable Actuarially Determined Contributions

Our understanding is that this requirement would primarily affect public sector and church plans. In these situations, some or all of the elements of the normal contribution calculation may be selected by a party other than the actuary. Similar to some of the discussion above, we believe it is appropriate for the actuary to use these calculation elements if they are not unreasonable (in the case of assumptions) or not inconsistent with the other ASOP requirements (in the case of other calculation elements) even when those calculation elements may not have been those that would have been selected independently by the actuary. As the requirement is currently written, it is not clear that this approach would be permitted. For example, it is not clear that the reasonable assumptions used in the calculation can be assumptions selected by another party that the actuary has determined to be reasonable, or if they must be those that would have been selected independently by the actuary. Clarifying the requirement to permit greater reliance on calculation elements selected by others would avoid requiring two separate calculations that differ only slightly from one another, and would allow for greater consistency between calculations in those situations when two separate calculations are required.

Section 3.21 of ASOP 4—Gain and Loss Analysis

We support this change as written.

Section 4.1 of ASOP 4—Communication Requirements

We noted the following:

1. 4.1(l) As noted above, we do not believe this requirement is appropriate as written

2. 4.1(o) For clarity, the phrase "that differ from assumptions used for the primary measurement" could be appended.

3. 4.1(r) We believe that for funding valuations, this requirement requires the actuary to produce information that, if 3.11 is retained, will no longer be particularly useful and not worth the cost to generate.

4. 4.1(w) As noted above, we have significant misgivings about this requirement as written.

ASOP 27 – Appendix 2

The exposure draft did not make any changes to the discussion in Appendix 2 on the use of arithmetic versus geometric returns. A recent practice note (released as an exposure draft, and close to being released in final form) discusses this issue more fully. This practice note advances the discussion of this issue and we believe that it should be referenced in the discussion in Appendix 2 and that actuaries should be encouraged to consider the discussion in this practice note when selecting a discount rate that is based on expected returns.

Thank you for the opportunity to comment on the exposure draft. If you have any questions, please contact Jim Verlautz (612 642 8819) or me (212 345 7257).

Sincerely,

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