

July 29, 2019

ASB Comments
American Academy of Actuaries
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Via email to comments@actuary.org

ASB Committee,

Thank you for the opportunity to comment on the second exposure draft of the proposed “Setting Assumptions” ASOP. Our comments are included below and organized by section number.

1.1 Purpose

Though the intent of the purpose was likely to keep it succinct, the purpose is inconsistent with the scope in that it only refers to actuaries that are setting assumptions. To be consistent with the scope, the purpose should refer to both actuaries that are involved in setting or reviewing assumptions.

1.2 Scope

“Practice-area” and “cross-practice” ASOPs are referred to, but these are not defined terms. While most actuaries can likely deduce which ASOPs belong to each of these two categories, it would be helpful if specific ASOPs were used to define these terms so that the intended order of hierarchy at which ASOPs should apply is clear.

2.1 Assumption

Should this definition clarify that assumptions are values that are not known at the time the work product is developed and to the fact that there is uncertainty in an assumption? Data is a known value. Assumptions are unknown at the time of the analysis.

3.1 General Considerations

Please clarify the meaning of the wording, “The actuary should identify and set assumptions that take into account the following”. Should it be read as, “The actuary should identify the following, and the actuary should set assumptions that take into account the following” OR as, “The actuary should identify assumptions and set assumptions that take into account the following”?

If the former, should the word “identify” instead be “consider”?

If the latter, is the language intended to create a requirement that every assumption be explicitly documented in the assignment? According to the language in section 4.1 indicating that actuarial reports should include a description of each “significant” assumption, it seems the intent is not to require that every assumption be documented, therefore, the word “identify” should be removed in section 3.1.

Also, the actuary setting an assumption should take into account the data to which the assumption will be applied, in addition to the data underlying the assumption. Different base data, for example fee-for-service versus managed care in Medicaid rate development, may require different assumptions be applied. This should be added as a consideration.

3.3 Assumption Margins

The draft language does not include any language that specifically addresses what may be done in situations where the historical data informing the assumption has been volatile. For example, in the health industry, historical pharmacy trends have varied dramatically in recent years due to reasons such as increased generic utilization and introduction of high cost drugs (e.g. Hepatitis C drugs). Because of this historical volatility, when setting pharmacy trend assumptions, health actuaries may consider it prudent to include margin in their pharmacy trend assumption. Under the current draft language, it is unclear if this would be allowed, therefore, we suggest the ASOP include “historical volatility” in 3.3.a as a consideration when developing assumption margins.

3.4 Reasonableness of Assumptions

3.4.b. requires that an assumption reflect the actuary’s professional judgment to meet the definition of a reasonable assumption. We suggest including language requiring that, for similar assignments, the actuary compare their historical professional judgment to what actually happened to determine if their judgment is skewed. For example, if a health actuary setting trend assumptions has consistently under- or over-projected trend rates, they should consider if they have a bias that is causing this consistent under- or over-projection

Also, 3.4.d. states, “it is expected to have no significant bias (i.e., it is not significantly optimistic or pessimistic) relative to the purpose of the assignment, except when a margin is included (as discussed in section 3.3).” How does this apply in situations where a range is used for an assumption? For example, Medicaid capitation rates will often be developed using ranges. To comply with this ASOP, would the range of potential reasonable assumptions narrow? Or, does “relative to the purpose of the assignment” give the actuary latitude to create assumption ranges including pessimistic and optimistic assumptions?

3.4.c. Requires an actuary to consider experience in determining reasonableness of assumptions. Assumptions should reflect future expectations. Therefore, future expectations, not just past experience, should be considered in assessing the reasonableness of assumptions.

Finally, what is the intention of including “except when a margin is included” in the language? Actuaries have traditionally included both explicit and implicit margins in their work product. Is it okay for an assumption to be pessimistic as long as the incremental margin between the best estimate and pessimistic assumption is called out as margin? And, is it also okay for an assumption to be optimistic if the embedded negative margin is called out? In other words, must all margin be explicitly identified? This would complicate assumption setting and documentation of assumptions compared to what has traditionally been done, especially if this standard is applied to every analysis an actuary performs.

3.5 Consistency of Assumptions

The current draft language states that assumptions for which the actuary is taking responsibility should be reasonably consistent. This language allows for assumptions within the assignment to be inconsistent if the actuary is taking responsibility for only certain assumptions while other assumptions were set by someone else. This could be interpreted as allowing the actuary to complete an assignment including inconsistent assumptions, which should not happen.

We suggest adding language clarifying that all assumptions should be reasonably consistent, or, at a minimum, consistent with section 3.4.4 of ASOP 41, include language stating that the actuary must disclose if an assumption selected by another party significantly conflicts with the actuary's professional judgment.

3.6 Reasonable Assumptions in the Aggregate

Similar to the comment on 3.5, if the assignment includes assumptions set by others, the actuary should find all assumptions reasonable in aggregate, not just those assumptions set by the actuary. Therefore, we suggest adding language clarifying that all assumptions are reasonable in aggregate, or, at a minimum, consistent with section 3.4.4 of ASOP 41, include language stating that the actuary must disclose if an assumption selected by another party significantly conflicts with the actuary's professional judgment such that the assumptions in aggregate are unreasonable.

3.9 Reliance on Assumptions Set by Another Actuary

Similar to the comments on 3.5 and 3.6, if an actuary is relying on an assumption set by another actuary, the relying actuary should ensure that the other actuary's assumption is consistent with other assumptions and is considered in determining overall reasonableness, in addition to being appropriate for the assignment.

4.1 Required Disclosures in an Actuarial Report

4.1.b. states that the actuary should disclose "the information and analysis used for setting each significant assumption in sufficient detail to permit another qualified actuary to assess the reasonableness of the assumption." This language may be overly burdensome, since another qualified actuary could theoretically need access to all historical data that was used in setting the assumption, which seems like an unreasonable expectation. Also this language seems to place an overly burdensome documentation requirement on the actuary.

We suggest that the language be altered to align with ASOP 41, which states in section 3.2 (emphasis ours), "In the actuarial report, the actuary should state the actuarial findings, and identify the methods, procedures, assumptions, and data used by the actuary **with sufficient clarity that another actuary qualified in the same practice area could make an objective appraisal of the reasonableness of the actuary's work** as presented in the actuarial report."

4.2 Additional Disclosures

4.2.a. In practice, implicit margin is quite often included in projections by adding some conservatism to other assumptions. If margin must be documented, actuaries must now identify and quantify these amounts, which would make the margins explicit. This section appears to eliminate the ability of an actuary to include implicit margin in assumptions. Is that the intent of this ASOP?

Thank you for considering these comments.

Respectfully,

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