TOWERS
PERRIN

July 31, 2008

Actuarial Standards Board
1100 Seventeenth Street NW
Washington, DC

Dear Gentlemen:

RESPONSE TO REQUEST FOR COMMENTS REGARDING ASOP 27

As the Chief Actuary in the Human Capital Group, I am providing you with Towers Perrin's response to your Request for Comments regarding Actuarial Standard of Practice No. 27. These comments were prepared by actuarial leadership of the Human Capital Group of Towers Perrin, which includes the retirement and health & welfare practices. Towers Perrin's Human Capital Group employs over 600 actuaries who are members of one or more of the U.S. actuarial organizations that sponsor the ASB.

Overall Comments

We support the ASB's commencing this effort to update ASOP 27 to reflect changes in actuarial practice since its adoption. However, we believe that it would be beneficial to review all of the ASOPs related to selection of assumptions together, perhaps consolidating them in to a single standard. In addition, while ASOP 27 and ASOP 35 were written as pension standards, they subsequently were applied to the selection of assumptions for measuring retiree group benefits by the revisions to ASOP 6. This fact should not be forgotten as these standards are reviewed and should be reflected in any revisions that are adopted.

Specific Responses

We have reviewed and discussed the specific questions posed by the ASB. Our responses are set forth below.

<u>Question 1:</u> We do not support the continued use of a "best-estimate range" in ASOP 27 with the actuary selecting a specific point within this range. In our experience, actuaries rarely explicitly develop a best-estimate range as a starting point in the assumption selection process. Instead, they use the alternative afforded by the ASOP to select assumptions that they are confident would fall within such a range.

The best-estimate range as defined in the ASOP can be very wide. ASOP 27 provides little guidance to the actuary on how to select an assumption from within that best estimate range. Since the range can be very large, an actuary is free to choose an assumption that he may feel is not truly his "best estimate" and yet still refer to it as a best estimate assumption selected in accordance with ASOP 27.

There are also many circumstances under which the purpose of the measurement may require use of an assumption outside of the defined "best-estimate range" or that is not the actuary's best estimate, such as when evaluating the impact of or probability of adverse outcomes. Plan sponsors have increasingly engaged actuaries to perform risk identification and mitigation projects that include these calculations.

As described in more detail in our response to Question 2, we believe that the ASOP 35 concept of selecting appropriate, reasonable assumptions from an assumption universe is a more appropriate standard of practice.

<u>Question 2:</u> The concept of an assumption universe from which the actuary selects an appropriate, reasonable assumption should be applied to the selection of economic assumptions. While it could be argued that economic assumptions might lend themselves to a more data-driven approach to selection, we strongly prefer a standard that relies on the actuary's judgment to select the appropriate assumption. We urge the ASB to consider a standard that states that the actuary should select a reasonable assumption that is appropriate for the purpose of the measurement. In some situations this will be the "expected" value of the assumption; in other cases it may be an assumption that is significantly higher or lower than the expected value. We believe that a standard of practice on assumption-setting built along these lines could define the types of assumptions and also address factors to consider in developing an assumption universe, selecting an assumption appropriate for the purpose of the measurement (perhaps by example, such as selecting the expected value of the assumption when the purpose of the measurement is to provide the actuary's best expectation), and examining consistency of related assumptions.

<u>Question 3:</u> Changing the basis for selecting economic assumptions from "a point within the best-estimate range" to "a value that is reasonable and appropriate for the measurement" avoids the deviation issue. The actuary becomes responsible for determining what sort of assumption is appropriate and should be charged with documenting that decision. If the ASB retains the "best-estimate range" concept, then the ASOP should clearly allow for either (a) assumptions outside of the range if they are more appropriate to the purpose of the measurement (such as stress testing) or (b) defining the "best-estimate range" to be dependent on the purpose of the measurement and not necessarily the smallest band within which it is more probable than not that the actual value will fall.

Question 4: It would be appropriate to include the asset valuation or smoothing method in the list of factors the actuary should consider when selecting the investment return assumption. However, because the role of the asset valuation or smoothing method in the selection of assumptions will vary based on the purpose of the measurement, we would not support a stronger statement (such as requiring that the difference between actual asset values and smoothed asset values be an input to the actuary's selection of an investment return assumption).

Question 5: The statement in paragraph 3.6 that "Generally, the appropriate discount rate is the same as the investment return assumption" is no longer appropriate. The two are often determined separately. This statement should be removed. On the other hand, we do not believe that it would be appropriate to provide guidance that the discount rate could not reflect the returns on assets invested to support the liabilities. Instead, we believe the standard of practice should make clear that the selection of the discount rate depends on the purpose of the measurement.

In addition, the description of the method for selecting the appropriate assumption should contain a statement that the actuary should consider whether and how the optionality of embedded minimums and maximums affects the assumptions. For example, consider a variable cash balance crediting rate that has a minimum of 4%. A valuation that uses only best estimate assumptions may not assign a value to this option if the economic variable referenced by the crediting rate is expected to exceed 4%. Explicitly utilizing option-pricing techniques may be appropriate in many circumstances. It may also be appropriate to implicitly estimate the effect by using a higher crediting rate assumption. ASOP 27 should allow both of these practices.

Question 6: Financial economics is an important viewpoint that the actuary should consider. ASOP 27, in our view, has always allowed the actuary to reflect this view in the selection of assumptions. Striking the sentence in paragraph 3.6 referred to in our comments concerning Question 5 would make this clearer. The need to accommodate a financial economics point of view reinforces that the standard should allow the actuary to exercise judgment when selecting assumptions in a manner consistent with the purpose of a specific measurement. For example, it may be appropriate to apply a more traditional perspective in one situation while applying classical financial theory in another. The actuary should be familiar with a broad body of knowledge and must be empowered to employ the technique most suitable to each specific situation.

Question 7: We do not see the need for a new section or standard containing additional guidance for the selection of economic assumptions for purposes other than measuring pension obligations. As long as the standard allows the actuary to select assumptions in a manner consistent with the purpose of the measurement and does not restrict the actuary to “best estimate” type assumptions for all measurements, no separate section or standard should be necessary. Naturally, it may be helpful for the standard to use examples of measurement purposes such as analysis of pension risk to illustrate why the actuary needs to consider the purpose of the measurement when selecting assumptions.

<u>Question 8:</u> We do not believe any additional disclosure is required. However, the current language should make it clear that required disclosure is restricted to significant assumptions.

<u>Question 9:</u> Our only other area of concern with ASOP 27 (and this also applies to ASOP 35) is that it is written for pension obligations but also used for retiree group obligations. This fact should be recognized in the standard, perhaps by changing the name to Selection of Economic Assumptions for Measuring Benefit Obligations and by modifying the wording throughout to reflect its application to both pension and retiree group benefits.

<u>Question 10:</u> At a minimum, the ASB should consider reviewing ASOPS 27 and 35 together to ensure that they are consistent. We would prefer for the ASB to combine them into a single standard because we think the same fundamental approach should be used to selecting both types of assumptions.

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Thank you for this opportunity to assist the ASB as it considers how to update ASOPs 27 and 35. Please contact me if you have any questions or would like to discuss our comments.

Sincerely,

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