

January 28, 2014

ASOP No. 35 Revision  
Actuarial Standards Board  
1850 M Street NW, Suite 300  
Washington, DC 20036

Dear Sir or Madam:

This letter documents the response of Towers Watson to the Proposed Revision of Actuarial Standard of Practice (ASOP) No.35, *Selection of Demographic and Other Noneconomic Assumptions for Measuring Pension Obligations*, as requested in the Exposure Draft of September 2013. Towers Watson is a global human capital and financial management consulting firm specializing in employee benefits, human capital strategies, and technology solutions. 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 generally support four central themes that we believe apply to the Actuarial Standards of Practice.

- 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 and should not seek to substitute rules for the actuary's reasonable professional judgment.
- The ASOPs should set forth minimum professional standards, not best practices. 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 that 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 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 this work only for our client. No other person or entity can expect to rely on our work. We strongly believe that any ASOP that explicitly provides for or allows a presumption that actuaries perform work for the general public will expose actuaries to unwarranted and unmanageable risk.

We appreciate the opportunity to comment. Our specific feedback on the Exposure Draft follows:

Section 3.1 Overview – We recommend that the penultimate sentence be changed to read “For any given measurement, the actuary will typically be able to identify two or more reasonable assumptions for the same contingency.” We also suggest that the last sentence (“In some instances, the actuary may present several results to illustrate the effect of alternative reasonable assumptions”) be stricken. We do not believe this sentence adds anything useful, as nothing in the ASOPs would prevent an actuary from providing alternative scenarios. We are concerned that this sentence might be read to imply that alternative scenarios are required when there are multiple reasonable assumptions.

Section 3.3.2 Consider the Relevant Assumption Universe – The list labeled as “information relevant to many demographic assumptions” consists mostly of **observed** results - studies of actual experience (either of the plan sponsor’s employees, or of broader groups), observed general trends, etc. We believe that plan sponsor expectations should be explicitly included in the list. In many situations, the effect of past or future events (e.g., window programs, layoffs, corporate transactions, compensation or benefits program changes, trends in the employer’s business, etc.) can change expected future retirements, terminations and disablements, so that observed experience is no longer a good estimate of future experience. While Section 3.3.4 (Select the Specific Assumptions) includes a reference to “relevant factors known to the actuary that may affect future experience”, and discusses not giving undue weight to past experience, and Section 3.10.6 includes the plan sponsor in the list of “experts”, we believe that since the specific assumptions to be chosen are chosen from the relevant assumption universe, the concept that the assumption universe may include expectations not yet evidenced in observed results is important.

One-time Events — There are references to one-time events in Sections 3.3.2 and 3.3.4. We believe that reflecting one-time events in assumption setting is complex and warrants a more thorough discussion. Anticipation of such events in the future is precluded for certain required measurements (i.e., assumptions are to reflect voluntary employee behavior) but might be appropriate for other measurements (such as internal planning). While the Exposure Draft accommodates both of these via Section 3.3.5.a’s requirement that the assumption be appropriate for the purpose of the measurement, we suggest that explicit mention of this distinction be included.

If an event has occurred, the Exposure Draft rightly questions whether it is reasonable to assume that past experience will continue. However, this is only one of many questions to be asked in such a situation. For example, should the predictive value of experience prior to the event be questioned? Many events occur in poor economic conditions (either for the broad economy or for the company) and employees may tend to voluntarily leave their jobs less

frequently under such circumstances. Furthermore, near term future behavior may be affected by the event. For example, a voluntary severance or retirement program might result in artificially low voluntary rates of decrement for a few years as the incentives offered may have accelerated the termination of many who might otherwise have left voluntarily in the next few years. We believe that a discussion of factors such as these should be included so that actuaries appreciate the complexity that one-time events can introduce to the assumption setting process.

Sections 3.5.1 Retirement and 3.5.2 Termination of Employment — We believe that the factors listed in 3.5.2.a affect rates of retirement as well as rates of termination, and thus believe they should also be referenced in 3.5.1.

Section 3.5.3 Mortality and Mortality Improvement – We believe that this section should be reworded to be more even-handed regarding assumptions about mortality improvement. As currently worded, there is a strong inference that continuous mortality improvement based on rates observed in the past is to be assumed. For example:

- Immediately after 3.5.3.c. it says “The actuary should reflect the effect of mortality improvement both before and after the measurement date”. On its face this suggests mortality improvement is to be assumed to continue, even though 3.5.3 i and ii later make clearer that is not required. To avoid confusion, we believe this sentence should be refocused to say something like “The actuary should reflect the mortality rates expected to be experienced over the lifetimes of the plan participants that will determine the period of time for which their benefits are paid”.
- The last sentence of Section 3.5.3 ii. reads “Note that the existence of uncertainty about the occurrence or magnitude of future mortality improvement does not by itself mean that an assumption of zero future improvement is a reasonable assumption”. We recognize that this sentence exists in current ASOP 35, but we believe the sentence should be stricken. Alternatively, it should be changed to more even-handedly acknowledge the highly speculative nature of continuous mortality improvement and emphasize that no particular assumption should be used without careful consideration, e.g., “Note that the existence of uncertainty about the occurrence or magnitude of future mortality improvement does not by itself mean that either an assumption of zero future improvement, or an assumption that mortality improvement will continue at the same rate as experienced during a given time period in the past, is a reasonable assumption.”

Sections 3.10.1 Adverse Deviation or Plan Provisions that Are Difficult To Measure. Section 4.1.1 provides that “The description should also include a disclosure of any explicit adjustment made in accordance with Section 3.10.1 for adverse deviation or valuing plan provisions that are difficult to measure as discussed in ASOP 4”. We agree that only an “explicit” adjustment should be required to be disclosed. Merely considering the potential for adverse deviation as one factor in selecting an assumption from a range of reasonable assumptions should not trigger a disclosure requirement. Such an implicit adjustment does not require precise definition of the reasonable range nor quantification of the adjustment.

However, we note that it is not entirely clear that only explicit adjustments must be disclosed, because Section 3.10.1 requires that an adjustment be disclosed without mentioning the word “explicit”, and could be read to require a disclosure in the common case where an actuary picks assumptions that are more toward one end or the other of the “range of reasonable

assumptions” discussed in Section 3.4, rather than toward the middle, with the intention of providing a margin for adverse deviation. We suggest that the language in Section 3.10.1 be clarified.

Sections 3.10.2 and 3.10.3 Materiality and Cost of Using Refined Assumptions. The first sentences of these two sections use slightly different wording that may or may not intend different meanings. If the meanings are intended to be the same, we suggest that the word “assumptions” in the first sentence of 3.10.2 be changed to the defined term “demographic assumptions” and the wording “establish a balance” in the first sentence of 3.10.3 be changed to “consider the balance” as used in 3.10.2. If the different wording was intentional, the intended difference should be clarified. One way to address this may be to simply combine these two sections into one, as they appear to be discussing very similar concepts.

Sections 4.1.1 Assumptions Used. The sentence “The actuary should describe each significant demographic assumption used in the measurement and whether the assumption represents an estimate of future experience, the actuary’s observations of the estimates inherent in market data, or a combination thereof” comes from ASOP 27 (with the exception of the addition of the word “demographic”). We believe the sentence should be modified to be more appropriate for use with demographic assumptions. Nothing in ASOP 27 clarifies what “market data” means in the context of demographic assumptions, but the actuary is likely to infer that it means broad studies of a demographic assumption (e.g., mortality studies, Social Security disability incidence data, etc.). However, for demographic assumptions, the most likely scenario – that the assumption is based on a combination of the experience of the **specific** group in question and expectations about the future – is not listed as one of the three choices for the expected disclosures.

Sections 4.1.2 Rationale for Assumptions, 4.1.3 Changes in Assumptions and 4.4 Confidential Information. These sections are identical to those already adopted in ASOP 27. However, demographic assumptions differ significantly in character from economic assumptions. Most economic assumptions are not plan sponsor or industry specific, with some exceptions (e.g., assumed rates of future compensation increases), and market data and economist forecasts are available. Given the continual changes experienced by many plan sponsors (e.g., significant changes in retirement benefit programs, changes in the organization, window programs or layoffs, changes in economic conditions in general), in many cases setting demographic assumptions is as much about predicting the future as it is about studying the past. In addition, future mortality improvements are speculative. In many cases, the past will be reviewed, but the assumptions chosen will largely be driven by future expectations. In such an environment, we expect the requirement to disclose the rationale for demographic assumptions to be met with a significant amount of boilerplate language about future expectations, which we do not believe enhances the value of the actuarial work product.

In addition, we continue to have concern that the rationale for changes in certain demographic assumptions (such as termination or retirement rates) may be based on business information that the Principal would not want to disclose. Such disclosure may even be prohibited by the terms and conditions of the actuary’s contractual arrangement with the Principal. While Section 4.4 indicates that “Nothing in this standard is intended to require the actuary to disclose confidential information”, it is not clear what Section 4.4 means in practice. We believe that the section should be clarified to state that the Principal is responsible for determining what information is confidential. Demographic assumption changes are often driven at least in part by future expectations based on business plans that the Principal may not want specifically

disclosed. Again, we believe that the result may be many boilerplate disclosures that reference the general business outlook expected by the Principal as part of the rationale for changes.

We have additional comments on these sections, as follows:

Sections 4.1.2 Rationale for Assumptions. We request a specific statement that the actuary should use his or her professional judgment in determining which demographic assumptions have “a significant effect on the measurement”. We note that neither this Exposure Draft nor ASOP 1 define “significant” in a way that would be useful in interpreting this section. The ASOP 1 discussion of the term “significant” is as follows:

*Significance/Significant*—Significance can have different meanings. A result may be deemed to be statistically significant if it is determined that the probability that the result was produced by random chance is small. An event may be described as significant if the likelihood of its occurrence is more than remote. In addition, a result may be significant because it is of consequence. Other uses may be encountered in actuarial practice. The actuary should exercise care in interpreting or using these words.

In addition, we find this section unclear with respect to “prescribed assumptions or methods set by another party”. Under US Generally Accepted Accounting Principles (GAAP) and International Financial Reporting Standards (IFRS), demographic assumptions used for accounting purposes are the responsibility of the plan sponsor. Section 1.2 makes clear that this standard applies to the actuarial advice given to the plan sponsor who selects such assumptions. We would interpret that to mean that any actuarial communication to the client that recommends demographic assumptions must include the rationale as described in Section 4.1.2. However, once the plan sponsor has chosen those assumptions, they will likely remain in effect for several years and we interpret Section 4.1.2 as providing that subsequent actuarial communications that use those assumptions need not include the rationale, as once the advice has been given and the assumptions chosen, the assumptions then are “prescribed assumptions or methods set by another party” for which the rationale need not be included. We request that this section make that clearer.

Sections 4.1.3 Changes in Assumptions Similarly, Section 4.1.3 should make clear that the rationale for a change need not be provided the first time the assumptions are used where the actuary provided advice and the client chose the assumptions, because at that point the assumptions are prescribed assumptions. We also believe, in furtherance of this clarification, that the phrase “For assumptions that are not prescribed” needs to be replaced with the more precise “For assumptions that are not prescribed assumptions set by another party or prescribed assumptions set by law”. Alternatively a definition of “prescribed assumptions” that includes both types could be added (e.g., it could be incorporated either in the definition section or in Section 3.8, which also uses the term “prescribed assumptions” without clearly indicating that both types are included.) Note that ASOPs 4, 6 and 41 to which Section 3.8 refers do not use the term “prescribed assumptions” generically to include both types. This would also be helpful for Section 4.2, although there the context makes clearer that the term “prescribed assumptions or methods” is intended to include both those prescribed by law and prescribed by another party. We acknowledge that the same concerns exist in the newly published ASOP 27.

Section 4.1.4 Changes in Circumstances. We presume that the reference to following the guidance in ASOP 41 if circumstances change that might have led to different demographic assumptions is a reference to Section 3.4.6 Subsequent Events of ASOP 41. Section 3.4.6 requires disclosure of events that happen after the measurement date that would have a “material effect on the actuarial findings” if “it is impractical to revise the report before it is issued”. It may be unclear to the reader what this means in the context of demographic assumptions for pension measurements. For most pension measurements (e.g., for funding measurements for qualified plans, and for accounting measurements) it is not appropriate under the various regulatory requirements to recognize events that occur after the measurement date, with limited exceptions. While Section 3.4.6 uses the words “unless it is impractical to do so”, and the definition of the word “practical” in ASOP 1 would likely lead a reader to conclude that no disclosure is necessary in such circumstances (specifically the sentence in the definition “Thus, it is appropriate for the actuary, exercising professional judgment, to decide that the circumstances surrounding a particular assignment are such that it would not be necessary to undertake a particular task), we believe it would be helpful if this ASOP directly acknowledged that in many cases reflecting such changes in circumstances as of the measurement date is not appropriate in the context of the measurement.

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,



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