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April 27, 2017

Maryellen Coggins
Chairperson
Actuarial Standards Board
1850 M Street NW, Suite 300
Washington, DC 20036
Via email to: comments@actuary.org

Re: Proposed Actuarial Standard of Practice, *Setting Assumptions*

Dear Maryellen:

On behalf of the Enterprise Risk Management and Own Risk and Solvency Assessment (ERM/ORSA) Committee of the American Academy of Actuaries,¹ I appreciate the opportunity to provide comments on the exposure draft of the proposed actuarial standard of practice (ASOP), *Setting Assumptions*.

The primary purpose of our review of the draft was to identify significant issues or concerns regarding the content of the draft. We recommend the Actuarial Standards Board (ASB) clarify the purpose of this proposed ASOP so that actuaries understand how this ASOP is intended to be applied, especially when there is a conflict with other ASOPs, such as the proposed *Modeling* ASOP.

We have the following responses to the specific questions listed in the exposure draft memorandum:

1. *In some circumstances, the setting of assumptions is largely inseparable from the selection of methodology. The standard addresses this issue by including such methodology in the discussion of “assumptions” in section 1.2. Is this sufficiently clear?*

Response: Definitions (and/or examples) of assumptions, methodology, and model would help clarify where assumptions and methodology are inseparable.

¹ The American Academy of Actuaries is a 19,000-member professional association whose mission is to serve the public and the U.S. actuarial profession. For more than 50 years, the Academy has assisted public policymakers on all levels by providing leadership, objective expertise, and actuarial advice on risk and financial security issues. The Academy also sets qualification, practice, and professionalism standards for actuaries in the United States.

There is a definition of model currently proposed in section 2.7 of the *Modeling* ASOP exposure draft; this ASOP could refer to the *Modeling* ASOP for the definition of model when the Modeling ASOP is finalized and adopted.

2. *Does the proposed standard provide appropriate guidance across all practice areas? If not, how should the guidance be modified?*

Response: Yes; the draft also acknowledges the potential conflicts across practice areas and other standards of practice.

3. *Is the proposed standard clear on how to handle conflicts with practice-specific ASOPs? If not, how could it be improved?*

Response: The standard is clear.

This ASOP is general and is not prescriptive or area-specific. As a result, our expectation was that this ASOP would be the governing standard for assumption setting for all practice areas instead of supplemental guidance. We ask the ASB to share its rationale for providing this ASOP as a supplement as opposed to a governing standard? Would you also include narrative on where the gaps in guidance exist? In its current governing rank relative to other ASOPs and considering the content included in other ASOPs, we are uncertain of its value and need.

We suggest that this ASOP be the governing standard for setting assumptions, and the ASB needs to clarify which ASOP has precedence when application of this ASOP overlaps with other ASOPs.

4. *Would it be helpful to define additional terms in section 2? If so, what terms?*

Response: In addition to definitions of assumptions, methodology, and modeling mentioned in question 1, it would be helpful to define “consistency” of assumptions/assumption sets and “reasonableness.”

5. *Is the guidance in section 3.1.3(b) that the actuary should consider the reasonableness of the results from using the assumptions, and not simply the reasonableness of each individual assumption, clear and appropriate?*

Response: The guidance is clear and for the most part appropriate. In the last paragraph of 3.1.3.b, we recommend cautioning actuaries in their reliance on results to validate underlying assumptions. Unreasonable results may bring attention to unreasonable assumptions, but they may highlight unreasonable expectations of those reviewing the results.

6. *Does the proposed standard appropriately address sensitivity analysis as discussed in section 3.2?*

Response: It would be helpful to provide guidance on appropriate considerations for conducting sensitivity analysis. Examples could include:

- Entity-specific historical variation in the metric represented by the assumption
- Broader industry historical variation in the metric represented by the assumption
- Potential impact of entity-specific operational changes (underwriting, claims handling, etc.)
- Potential impact of industry trends (inflationary, social, legal, regulatory, etc.)
- Potential impact of extreme scenarios of material risk (mortality, flood, epidemic, etc.)

7. *Are the disclosures about assumptions and changes in assumptions in section 4.1 of the proposed standard clear and appropriate?*

Response: Yes, they are clear and appropriate.

In addition, we have the following suggestions in the following sections of the current draft of the ASOP:

Section 3:

- Section 3.1.1—Consider adding “unless the actuary is disclaiming responsibilities of the assumptions” at the end of the first sentence.
- Section 3.1.1.b—Consider changing to “Available and relevant data, including, where appropriate, the quality of such data as discussed in ASOP No. 23, *Data Quality*, and the credibility of any such data as discussed in ASOP No. 25, *Credibility Procedures*.”
- Section 3.1.3.d—Consider the following revision: “determine whether material assumptions, other than prescribed assumptions set by law, are reasonably consistent. **An assumption set is consistent if each of the individual assumption reflects expectations for the anticipated risk pool, based on its entry and renewability criteria.** The actuary should disclose any material inconsistency, **including inconsistent assumptions provided by others,** and the reasons therefor, in the actuarial communication in accordance with section 4.1(d).”
- Section 3.2—We recommend removing “Alternative” from section 3.2 for the application of sensitivity analysis.
- Section 3.4—Consider changing the first sentence to “Data and analyses relevant to the assumptions may be available from a variety of sources, **or the assumptions may be selected by those other than actuaries.** including the principal, representatives of the entity, investment advisers, demographers,

economists, scientists, statisticians, health care providers, and other professionals.”

This change will clarify that actuaries may rely on others for data and analyses relevant to the assumptions or for assumptions selected.

- Sections 3.1.3.a, 3.1.3.d, 3.1.4, 3.1.5, and 4.1 “Material”—Currently ASOP No. 1, *Introductory Actuarial Standard of Practice*, Section 2.6 has a definition of materiality. This ASOP can refer to ASOP No. 1 for the definition of materiality or define materiality separately in Section 2.

Thank you for this opportunity to provide our views on the current draft of the proposed actuarial standard of practice, *Setting Assumptions*. If you have any questions or would like to discuss this letter in more detail, please contact Nikhail Nigam, the Academy’s policy analyst for risk management and financial reporting issues, at 202-223-8196 or nigam@actuary.org.

Sincerely,

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Risk Management and Financial Reporting Council
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