AMERICAN ACADEMY *of* ACTUARIES

October 29, 2013

Actuarial Standards Board
1850 M Street, NW, Suite 300
Washington, DC 20036

Re: Comments Regarding Coordination Between Actuarial Standards of Practice (ASOPs) Involving Retirement Benefits.

Members of the Actuarial Standards Board:

On behalf of the American Academy of Actuaries'[1] Joint Committee on Retiree Health, Pension Committee, and Pension Finance Task Force, we commend the ASB for working to coordinate the actuarial standards regarding retirement benefits. In the transmittal letters for the ASOPs No. 4 and No. 6 exposure drafts (EDs), the ASB explicitly recognized the need for this coordination. And, as respondents to the exposure drafts for ASOPs No. 4, No. 6, and No. 27, we appreciate the opportunity to help address the need for better coordination of these standards and identify areas for more effective guidance for practitioners.

Coordination between standards will help those actuaries who are familiar with one practice and a particular standard to quickly and conveniently find relevant material when using a comparable standard governing a related practice area. Coordination will facilitate comparison of standards—enhancing a practitioner's understanding of appropriate practice in the less familiar practice area.

The ASB acknowledges in its transmittal letter for ASOP No. 4 that one goal is "for the two standards to be the same where possible and different where necessary." We agree with the ASB and suggest the appropriate balance has not quite been achieved. For example, there are several instances in which we find the differences are unnecessary and/or language intended to achieve coordination may create similarity when differences are appropriate. Particular instances include the following, although more specific recommendations will be discussed in the remainder of the comment letter:

- Section 3: This section in ASOP No. 6 is almost three times the length of the same section in ASOP No. 4. Balance could be achieved by adding several points to Section 3 in ASOP No. 4 that are included in ASOP No. 6 and would enhance coordination with

[1] The American Academy of Actuaries is a 17,500-member professional association whose mission is to serve the public and the U.S. actuarial profession. The Academy assists public policymakers on all levels by providing leadership, objective expertise, and actuarial advice on risk and financial security issues. The Academy also sets qualifications, practice, and professionalism standards for actuaries in the United States.

ASOP No. 4. At the same time, some of the detail in ASOP No. 6 could be moved to other standards or removed entirely.

- Sections 2 and 4: Making eliminations/reductions in Section 3 also would allow for reductions to the level of detail included in Section 2 (Definitions) and Section 4 (Disclosures) of ASOP No. 6.
- Section 1: The level of detail in this section could be reduced.
- Appendix: A common appendix explaining the differences in the two standards would be helpful. Also, ASOP No. 6 contains a detailed Appendix 1 and the absence of a corresponding Appendix 1 in ASOP No. 4 should be addressed. We would suggest eliminating much of the ASOP No. 6 Appendix 1 to achieve that objective.
- Avoid using different terms (e.g., cost, periodic cost, etc) to describe the same concept in different ASOPs. Similarly, avoid using subtly different wording in various ASOPs for definitions of the same term/concept.

In addition, we would encourage the ASB to review ASOPs No. 27, No. 35, and No. 44 with attention to their effect on retiree group benefit (RGB) practice.

Structural Differences

The EDs of ASOP No. 4 and ASOP No. 6 issued in the last two years have used the structure of the pension standard as the starting point for structural revision. Given the concern about the need to revise the pension standard, this would appear reasonable. An equally reasonable tack, however, might have been to model the structure of the two standards after the retiree group benefit standard, about which there had been little complaint. Strengths of the current ASOP No. 6, issued in December 2001, might be incorporated in the next versions of ASOP No. 4 and ASOP No. 6.

Section 1.1 in the standards, *Purpose*, is cumbersome because it includes statements that fit better under 1.2, *Scope*. The current ASOP No. 6 has a brief sentence for *Purpose* and five compact items under *Scope*, which cover financial reporting, cash-flow analyses, plan funding, cost projections, and determination of actuarial present values. We suggest this as a leaner model for the proposed standards.

The last paragraph in Section 3.1 in the standards, *Overview*, lists other applicable standards and then indicates that in the case of conflict, the present standard governs. But ASOP No. 6 is not mentioned in ASOP No. 4, nor is ASOP No. 4 mentioned in ASOP No. 6. It would be useful to acknowledge somewhere in the standards that ASOP No. 6 is for RGB <u>other than pensions</u>, so it is clear that ASOP No. 6 is not a standard for pensions, and that likewise, ASOP No. 4 is not a standard for RGBs.

Our comparison of differences in the structure of the two standards included an examination of the length and content of the standards and identified fundamental differences in the order and detail in each standard. For example, ASOP No. 6 is structured to specify the elements of an actuarial and arithmetic model—Section 3.5 to Section 3.13 address various elements of that model, first establishing the building blocks and then indicating how the actuary can ensure the integrity of the model.

The structure of ASOP No. 4, on the other hand, is not as clear and is less specific. For example, there is no reference to modeling, although that is increasingly the way actuarial education looks at the profession's work. Measurement is defined as a process, and procedures are outlined, but a key step (Section 3.2 (d) in ASOP No. 4) is simply defined as "gather data necessary," with little additional guidance in that step (Section 3.6). The building block foundations are less clear than if ASOP No. 4 was structured to identify the elements of a pension valuation model and give each appropriate weight.

Differing Levels of Guidance

A side-by-side comparison of the Tables of Contents, as seen in our spreadsheet labeled Exhibit A, indicates areas in which content matches, areas in which it differs, and the number of pages involved. Another clear distinction is the size of the two EDs—the PDF for ASOP No. 4 runs to 28 pages before reviewer comments, but the PDF for ASOP No. 6 is 58 pages before reviewer comments.

Two possible reasons for the length of ASOP No. 6 are 1) the need to set standards for RGB work that address not only the health and pension aspects of the work, but also the melding of those aspects into a unified projection and measurement; and 2) the ASB effort in recent years to coordinate guidance between the pension standard and the RGB standard. With this effort, Section 3 (the core substance of the standards) increased for ASOP No. 6 from 20 pages to 27 pages but only increased for ASOP No. 4 from 8 ¼ pages to 9 ½ pages. The added length in ASOP No. 6 is mainly due to the inclusion of ASOP No. 4 language into ASOP No. 6. The result is that guidance for RGB benefits in ASOP No. 6 (27 pages) is now three times the length of the 9 ½ pages of guidance for pensions in ASOP No. 4.

Differences in length are not necessarily problematic, but when coordination is the goal and one standard's Section 3 is almost three times that of the other, a closer look is required. ASOP No. 6 has always been long. Some of that was dealt with in the 2001 standard by referencing ASOP No. 27 and ASOP No. 35 (later joined by a standard on asset valuation, ASOP No. 44). ASOP No. 27, ASOP No. 35, and ASOP No. 44 do not specifically address non-pension retirement benefits. An RGB actuary, however, is responsible for following these standards with respect to assumptions and asset valuation methods that are not specifically addressed in ASOP No. 6. We encourage the ASB to now consider moving guidance in ASOP No. 6 focused on economic, demographic, and asset assumptions into ASOPs No. 27, No. 35, and No. 44. Language and structure in these standards can be crafted easily to minimize the confusion for actuaries expecting only pension guidance, while enhancing awareness of the importance of economic/demographic/asset assumptions for all practitioners. Those standards should be reviewed with attention toward their effect on RGB practice.

As noted above, much of Section 3 in ASOP No. 6 could be reduced to facilitate better coordination between the two standards.

Specific examples in Section 3 of these opportunities for coordination follow:

- There are seven subsections in ASOP No. 6 that do not have counterparts in ASOP No. 4; at least five are relevant for the pension actuary and should be coordinated with ASOP No. 4. All are discussed in more detail later: death benefits, model consistency and data quality, administrative inconsistencies, reasonableness of results, and roll-forwards.

- Even those subsections of Section 3 that have counterparts in both standards may be longer in ASOP No. 6 than in ASOP No. 4.

    - Guidance on plan provisions is a bit more than one page in ASOP No. 4 and three pages in ASOP No. 6.
    - ASOP No. 6 specifies guidance for handling covered population (over two pages). ASOP No. 4 has just two short paragraphs—listed under *Data* and not specific to a participant census—though the details of individual work history such as salary and service are far more important to a projection of retirement income benefits than they are to retirement health or death benefits.
    - ASOP No. 4 includes one sentence on actuarial assumptions; ASOP No. 6 includes five pages on it. The one sentence in ASOP No. 4 refers the actuary to other standards for economic and demographic assumptions. ASOP No. 6 also refers the actuary to those standards but uses two pages within the standard specifically on economic and demographic assumptions. Of the other three pages, some material has parallels in pension practice.

Concepts and Language

There may be different words used in the two standards for very similar concepts, due to differences in the way other words or terms are used. If someone has familiarity with one standard, this difference in terms in the second standard will lead to some difficulty in the transition. Coordination is needed. The ASB can facilitate this transition by minimizing the difference in terms and explaining the necessary differences. Explanation might be placed in either the *Scope* or *Definition* sections of both standards, although we recommend a common appendix that would read the same in all retirement benefit standards.

Coordination Opportunities

Coordination between ASOP No. 4 and ASOP No. 6, and more generally between ASOPs for the two practice areas, could be categorized a number of general ways.

1. Concepts are found in both standards but the language used has unexplained differences.
2. Concepts are found in both standards but they are more apt for one than the other.
3. Concepts are found in only one standard but might fit the other.
4. Concepts are found in both standards but need coordination.
5. A basic concept needs more prominence in both standards.

Specific examples are outlined further in this letter; other examples can be found in the comment letters for the EDs, mainly ASOP No. 6. If ASOP No. 4 had not been released some months in advance of ASOP No. 6, comments on coordination might have had a more prominent place in those comments.

We also note that the current EDs do include some areas that have been successfully coordinated. The guidance for *Approximations* and *Estimates* (Section 3.15 in ASOP No. 4 and Section 3.19 in ASOP No. 6), included in ASOP No. 6 exactly as written in ASOP No. 4, is an example of appropriate coordination. The guidance for *Volatility* (Section 3.16 in ASOP No. 4 and Section 3.20 in ASOP No. 6) is another relatively successful example of a concept and language included in ASOP No. 6 as written in ASOP No. 4 with some changes specific to the RGB situation. The use of auxiliary standards such as ASOP No. 27 for both practices is commendable, although RGB specialists should be brought into the drafting process to join pension specialists at the earliest moment.

Concepts same, language different. A major incidence of this is the use of "cost," which is discussed in Exhibit B. We feel "periodic cost" and "prefunding contribution" could be used in ASOP No. 4 as well as ASOP 6. "Measurement period" is defined in ASOP No. 6 but not in ASOP No. 4. The definition of "participant" differs—the definition in ASOP No. 6 is more open for active employees ("reasonably expected to receive coverage") than in ASOP No. 4. The general procedures in Section 3.2 seem better expressed in ASOP No. 6 than in ASOP No. 4.

It also is unclear what hypothetical data in Section 3.6.2 in ASOP No. 4 is anticipated, but we note that the JCRH letter[2] indicates some guidance about hypothetical data that would aid the RGB practitioner.

There are some significant language differences in the disclosures in Section 4.1 that do not seem necessary—Section 4.1 (i) in ASOP No. 6 reads much differently than Section 4.1 (i) in ASOP No. 4. The definition in ASOP No. 6 appears to require a description of the process for setting non-prescribed assumptions, even when they have not changed from the immediately preceding valuation. This requirement is not in ASOP No. 4 (although it may be in ASOP No. 27), raising the question of whether the ASB intends a difference in practice. Section 4.1(i) in ASOP No. 6 also appears not to necessarily require disclosure of sufficient information so that another actuary could accurately assess the reasonableness of the work, as is required in the second exposure draft of ASOP No. 4. Either the Section 4.1 (i) language in the two standards should be the same or language needs to be added so that any difference can be satisfactorily explained. We also note that the definitions in Section 4.1(i) through Section 4.1(s) in ASOP No. 4 and Section 4.1(x) in ASOP No. 6 are not necessarily inconsistent, but they describe different parts of what we recommend be a combined disclosure item. Other Section 4 items that have more material in ASOP No. 6 than in ASOP No. 4 are Section 4.1(d), Section 4.1(w), and Section 4.1(v).

As noted earlier, we recommend an appendix in each of the standards that would explain some of the differences that would exist once the ASOPs are approved.

[2] http://www.actuary.org/files/JCRH_ASOP-6_letter_Aug-29-2013.pdf

Concepts same, more apt for one standard. These are found most often in ASOP No. 4 Section 3.10 through Section 3.16, and seem less relevant to sections in ASOP No. 6. Important differences in practice may have been lost in the pursuit of identical or similar structure and language. Pension practitioners looking to ASOP No. 6 for guidance may be lulled by the similarities and attend less to the differences.

The length to which ASOP No. 6 addresses assets, vesting of benefits, and prefunding contributions is out of proportion to the time an actuary will spend on it. Editing for pertinence could reduce the material in Sections 3.14 through 3.18 that goes from the middle of Page 27 to end of Page 31 as well as numerous items in Section 2 and Section 4 that would not be there without the corresponding references in Section 3. Relatively few plan sponsors are prefunding RGBs and, of those, only a rare few target a funding level that would assume the current program will continue indefinitely. Vesting of any kind, in which the sponsor explicitly guarantees a multi-year benefit, is extremely uncommon (even in cases in which retirees continue to receive benefits, sponsors are reluctant to use language stating the benefits will always continue). While they may be needed for pension practitioners, including these paragraphs in a standard on RGB is potentially confusing, as the concepts described are rarely used and may be misunderstood in the RGB area. We also note that the term “actuarial value of assets” is used in several places, but the term is not defined in ASOP No. 4 or ASOP No. 6.

ASOP No. 6 addresses assets in more detail than ASOP No. 4, which simply references ASOP No. 44. For coordination, ASOP No. 6 would need to include a reference to ASOP No. 44. If ASOP No. 44 does not sufficiently cover the points now in ASOP No. 6, it should be revised to do so.

Both standards include Section 3.3.3 *Risk or Uncertainty* as a single sentence. But there is no guidance provided, which is unfortunate given the different risks in pension measurement versus RGB measurement. The comment made in the JCRH letter[3] applies to the coordination between the standards.

Concepts in one standard might fit the other. Sections 3.8, 3.9 and 3.10 in ASOP No. 6 seem to have parallels in pension practice but are not currently included in ASOP No. 4. With minor changes, they could be added to ASOP No. 4 and edited in ASOP No. 6 so that they are the same when possible and different only when necessary. Section 3.8 in ASOP No. 6 refers to death benefits and such benefits are found in pension plans. Section 3.9 in ASOP No. 6 refers to model consistency and data quality, and the guidance found there, if stated generally, would seem to be important to pension practice. Section 3.10 in ASOP No. 6 refers to administrative inconsistencies, which may be problematic in retiree health practice, but generally also have the potential to cause measurement problems in pension practice.

The guidance in ASOP No. 6, Section 3.12, regarding health care trend is about economic assumptions. Since ASOP No. 6 is now linked to ASOP No. 27 for economic assumptions, the

[3] http://www.actuary.org/files/JCRH_ASOP-6_letter_Aug-29-2013.pdf

template followed in ASOP No. 27 for the investment return assumption and the compensation increase assumption could be used for the health care trend assumption. Actuaries using ASOP No. 27 for guidance only on pensions could pay less attention to the health section, if the words “if applicable” are provided in the guidance. Possible structural efficiencies from putting current ASOP No. 6 guidance into ASOP No. 35 and ASOP No. 44 also should be considered. The disclosure sections in those standards and ASOP No. 27 should be examined for their effect on RGB practice and ASOP No. 6.

ASOP No. 27 has economic references for ASOP No. 4 in an appendix, but none for ASOP No. 6. If the health economic assumptions were covered in ASOP No. 27, which we recommend, presumably references also would appear.

ASOP No. 6 has Section 3.21 on *Reasonableness of Results*. As noted in the JCRH letter[4], “the absence of this section in ASOP No. 4 raises the question of why the RGB actuary needs to look at modeled cash flows, last measurements, etc., but not the pension actuary.” Sample participants are mentioned here, but never in ASOP No. 4.

Concepts in both standards but needing coordination. Consideration should be given to moving the present ASOP No. 6 Section 3.24 on roll-forwards into a new section under Section 3.4 on measurement date considerations.

Both standards have Section 3.5 addressing plan provisions but the structure differs, with no clear coordination. ASOP No. 6 may contain too much detail, while ASOP No. 4 could easily have more on eligibility, plan formulas, and limitations (e.g., is there a COLA?). ASOP No. 4, Section 3.5.3, *Other Valuation Issues,* is not about plan provisions for the most part. It is about alternative models for projecting payments, and we suggest it is not in the most appropriate place in the standard.

Section 3.6 does not match between ASOP No. 6 and ASOP No. 4 but could be coordinated around census data. In ASOP No. 6, the title is *Modeling Covered Population* and it runs to two pages. ASOP No. 6 separates guidance on population (Section 3.6) from guidance on financial inputs (Sections 3.7 and 3.8). On the other hand, ASOP No. 4 seems to put them both in two or three sentences in Section 3.6.

Section 3.7, *Other Information from the Principal,* in ASOP No. 4, also appears in ASOP No. 6, as Section 3.11, but provides almost no guidance. If that section is essential to good practice, it needs to be clarified and coordinated across the practices.

Section 3.10, *Measuring the Value of Accrued or Vested Benefits,* in ASOP No. 4 lists a number of items to be considered, including several that appear more relevant to the earlier plan provision subsection. We suggest moving those items to that earlier subsection. The items in Section 3.10 all seem to address pension obligations, so the subsection probably should come before the current Section 3.9, *Asset Valuation,* since Section 3.10 has nothing to do with assets

[4] http://www.actuary.org/files/JCRH_ASOP-6_letter_Aug-29-2013.pdf

but has a substantial connection to Section 3.8, *Actuarial Assumptions*. To the extent Section 3.10 is a more general section, it could be moved to an earlier location in the standard. The discontinuity in the ordering also affects the arrangement of these subsections in ASOP No. 6.

The concept of market-consistent present value (MCPV) is a problematic construct, continuing the challenge in reconciling actuarial terminology with the financial world's terminology. The definitions in the two standards are essentially the same, but introduce a new term rarely used in financial or actuarial work. The guidance in Section 3 contains differences, including the way default risk and sponsor financial health are addressed, that need either explanation or coordination (as does the one word difference in Section 4). In the request for comments in each ED, attention is drawn to connections with the working version of ASOP No. 27. The appendices of ASOP No. 27 provide some context for understanding the MCPV concept but do not acknowledge retiree group benefits. This absence is challenge to coordination, since the construct must apply to RGB obligations to be credible in the pension area. Within the real-world context of RGB, however, MCPV has severe limitations. An ASOP definition may state that a deep and liquid market is not a prerequisite for MCPV measurement, but that is not actuarial guidance. While default risk and sponsor financial health are noted, the underlying market reality for RGB is the sponsor's right, generally, to unilaterally modify or terminate the program, and that is not mentioned. The ED for ASOP No. 6 confuses the MCPV concept even more by positing, in Section 3.12.4, that the actuary <u>should assume</u> programs will continue indefinitely, which is completely inconsistent with market valuations. MCPV may be a way for the ASOPs to finesse the debate within the pension community about discount rates, but coordinating the construct with the RGB reality is necessary for credibility.

Concept missing in both standards. We have concerns about relegating mention of benefit payment projections, or cash flows, to a relatively minor position in both standards. Such cash flow projections are not mentioned in *Purpose* and only appear as an example in the sixth and last task in *Scope*. Payment projections, of course, are central to the actuarial calculation and are of value, not only as an entry point to measuring and allocating obligations, but as a planning and budgeting item or for asset/liability management.

The standards also make frequent reference to "benefit payments when due," which presupposes the actuary knows when aggregate payments are due. The most likely way an actuary will know that is through an actuarial projection of payments. The organization under *Scope,* Section 1.2, and the definition of "actuarial valuation" in Section 2.5, however, imply a cash flow projection is not a measurement of obligations and not an actuarial valuation. We question whether this was intended by the ASB.

The importance of payment projections deserves more prominence in both standards. ASOP No. 6 and ASOP No. 4 would be enhanced by recognizing benefit payment projections in Section 1.1, *Purpose*, and as the initial item listed under Section 1.2, *Scope.*

Conclusion

To effectively coordinate the two standards, we recommend the ASB look at the retirement benefit standards holistically, with detailed attention from both pension and RGB specialists in drafting the concepts and language. The differences between the pension practice and the RGB practice (primarily retiree health benefits) need to be examined, with an understanding that below-standard work in any practice is a disservice to the public and our profession.

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We hope that the ASB will give careful consideration to implementing these suggestions. We would be more than happy to discuss any of our comments and concerns with you. Thank you in advance for your consideration, and if you do have any questions, please contact David Goldfarb, the Academy's pension policy analyst, at 202.223.8196 or Goldfarb@actuary.org.

Sincerely,

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Exhibit A—Comparison Chart of Tables of Contents

See spreadsheet entitled *Exhibit A- ASOP 4-6 Compare - Table of Contents*

Exhibit B—Use of the Term “Cost”

The 2012 EDs of ASOPs No. 4 and No. 6 used the term “cost” to refer to the result of an allocation of a portion of a present value to a time period. In the 2013 ED of ASOP No. 6, the term “periodic cost” is used for the same concept, but it is still referred to as “cost” in the 2013 ED of ASOP No. 4. If someone were to read only one of the standards, the difference would not be noticed; however, for someone who reads both standards, the lack of coordination would be apparent. While “cost” is used more narrowly in the pension practice and in ASOP No. 4, confusion is still possible as “normal cost” is a separately defined ASOP term. In the definition of “cost allocation procedure,” which immediately follows that of “cost” in ASOP No. 4, the term “periodic cost” is used. If “periodic cost” were substituted throughout ASOP No. 4, as it has been in ASOP No. 6, and an explanation was included in a common appendix, confusion about the use of the term “cost” would be mitigated and coordination enhanced.

Such an appendix also might be the place for a brief discussion of common uses of “cost” versus the more specific concepts in the ASOPs. The word “contribution” is another example—it was replaced in the ASOP No. 6 ED by “prefunding contribution,” without a corresponding change in ASOP No. 4. (The change also was not made in the ASOP No. 6 reference to “contribution allocation procedure,” potentially creating confusion as to what “contribution” is subject to an allocation procedure.) The use of “prefunding contribution” should be considered seriously for ASOP No. 4. The term “plan contributions” is used often in ASOP No. 4, although the Section 2.7 definition of the single word “contribution” clearly implies *plan contribution*. Substituting “prefunding contribution” for “plan contribution” and, in some key places, for “contribution,” would make it easier for those actuaries looking to ASOPs for guidance in both pension and retiree benefits practices. Neither ED includes an explanation of why “cost” and “contribution” are distinguished, which might fit into an appendix for the ASOP.

We also note that in the last sentence of the ASOP No. 6 ED, the definition of “periodic cost” (Section 2.28) uses the term “cost.” It should be “periodic cost,” as “cost” is not a defined term in ASOP No. 6.

Exhibit A

2nd ED of ASOP # 4	**2nd ED of ASOP # 6**
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