Must or Should? Read: ASOP No. 1

JIM IS THE ACTUARY for a traditional multiemployer pension plan. The employees in the pension plan also participate in a trustee-directed defined contribution plan. For the defined contribution plan the Board of Trustees wanted to maximize the benefits provided to its members and asked Jim what changes could be made to the defined contribution plan that would protect them when investment returns were negative and share the gains when investment returns were greater than expected.

Jim provided the trustees with several options, including converting the defined contribution plan to a cash balance plan. The board ultimately decided on a cash balance plan with interest credits that were linked to an index with a minimum return and a provision that credited a percentage of the returns in excess of the assumed rate of return on the plan's assets.

In preparation for the first actuarial valuation of the new cash balance plan, Jim reviewed the applicable actuarial standards of practice (ASOPs). He had read the new version of ASOP No. 4, *Measuring Pension Obligations,* when it was released a few months earlier and recalled that it specifically discussed plan provisions that were difficult to measure, such as the crediting rate feature in his cash balance plan. Because the new version of ASOP No. 4 was not yet effective, Jim also reviewed the current version of ASOP No. 4 to see if it contained a similar discussion.

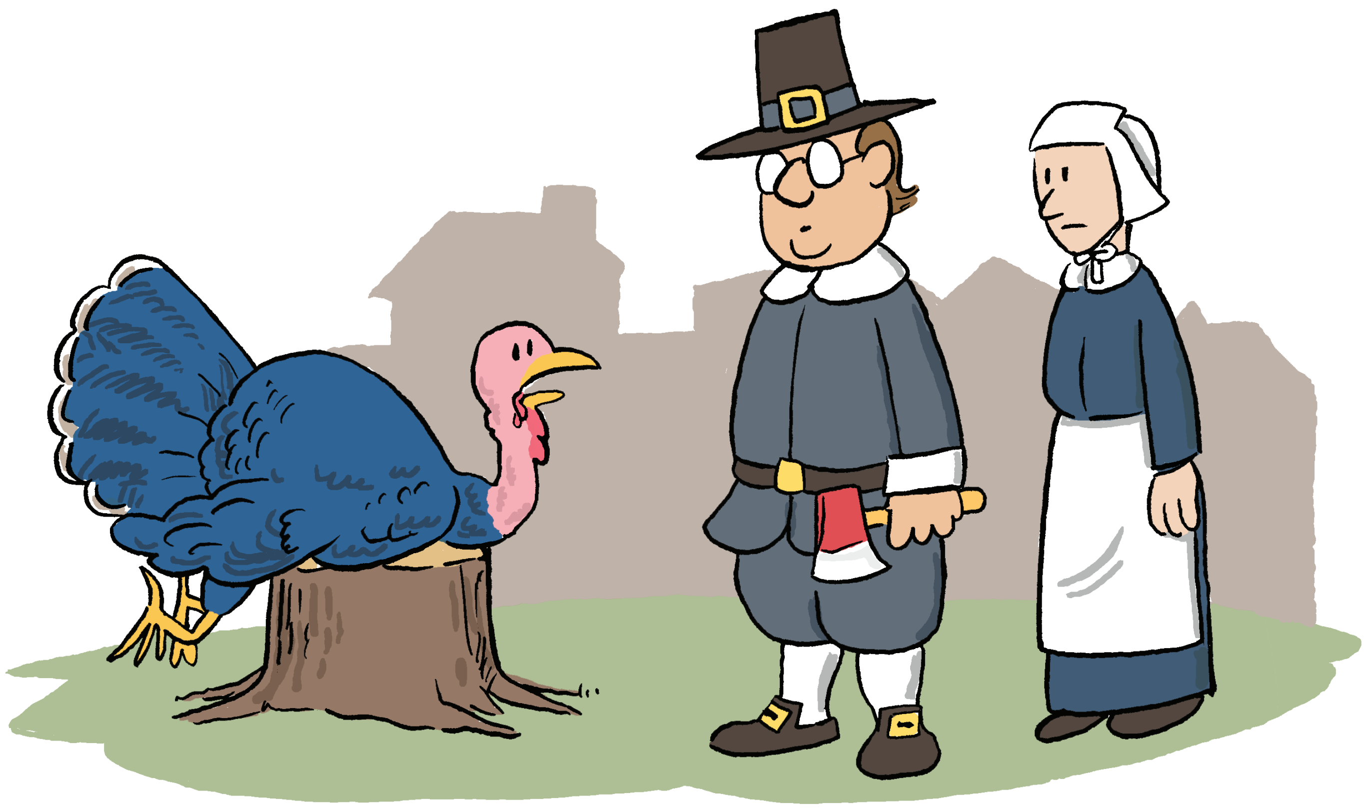
In the current version of ASOP No. 4, Jim found the following discussion of difficult-to-measure plan provisions under Section 3.9: "Some plan provisions may create pension obligations that are difficult to measure using deterministic procedures and assumptions.... In such circumstances, the actuary may consider using alternative procedures, such as stochastic modeling or option-pricing techniques, or alternative assumptions that include adjustments to reflect the plan provisions that were not explicitly valued. If, in the actuary's professional judgment, such plan provisions are significant and have not been reflected in the measurement, the actuary should so disclose in accordance with section 4.1(d)."

Difficult-to-measure plan provisions also were discussed in Section 3.5.3 of the new version of ASOP No. 4, as follows: "For such plan provisions, the actuary should consider using alternative valuation procedures, such as stochastic modeling, option pricing techniques, or deterministic procedures in conjunction with assumptions that are adjusted to reflect the impact of variations in experience from year to year. When selecting alternative valuation procedures for such plan provisions, the actuary should use professional judgment based on the purpose of the measurement and other relevant factors. The actuary should disclose the approach taken with any plan provisions of the type described in this section, in accordance with section 4.1(i)."

Jim noticed that the current version of ASOP No. 4 differed from the new version with the use of "may consider" versus "should consider." He turned to ASOP No. 1, *Introductory Actuarial Standard of Practice,* for a definition of these terms and found the following discussions of the terms "must/should," and "may":

Must/Should—The words "must" and "should" are used to provide guidance in the ASOPs. "Must" as used in the ASOPs means that the Actuarial Standards Board does not anticipate that the actuary will have any reasonable alternative but to follow a particular course of action. In contrast, the word "should" indicates what is normally the appropriate practice for an actuary to follow when rendering actuarial services. Situations may arise where the actuary applies professional judgment and concludes that complying with this practice would be inappropriate, given the nature and purpose of the assignment and the principal's needs, or that under the circumstances it would not be reasonable or practical to follow the practice. Failure to follow a course of action denoted by either the term "must" or the term "should" constitutes a deviation from the guidance of the ASOP. In either event, the actuary is directed to ASOP No. 41, *Actuarial Communications.*

The words "must" and "should" are generally followed by a verb or phrase denoting actions such as "disclose," "document," "consider," or "take into account." For example, the phrase "should consider" is often used to suggest potential courses of action. If, after consideration, in the actuary's professional judgment an action is not appropriate, the action is not required and failure to take this action is not a deviation from the guidance in the standard. However, the actuary should document in his work papers why no action was required. "May" as used in the ASOPs means that the course of action described is one that would be considered reasonable and appropriate in many circumstances. "May" in the ASOPs is often used when providing examples (for example, factors the actuary may consider; methods that may be appropriate). It is not intended to indicate that a course of action is reasonable and appropriate in all circumstances or to imply that alternative courses of action are impermissible.



"... and, while current guidelines suggest this course of action, personal judgment is allowed to be taken into consideration. Have you thought about fish?"

With a better appreciation of the difference between "may consider" and "should consider" Jim realized that the current version of ASOP No. 4 provided him more latitude in how he approached the gain-sharing provision of the plan than did the new version of ASOP No. 4. Under the current version, he could decide not to value the gain-sharing provision as long as he disclosed in his report that the plan provision had not been included. Under the new version of ASOP No. 4, valuing a gain-sharing provision was considered the appropriate practice, and Jim would need to consider alternative procedures to value the benefit. However, the new version of ASOP No. 4 continues to allow Jim to exercise professional judgment. A gain-sharing provision may be designed in such a way that the likelihood of exceeding the applicable threshold is very small, although this was not the case with Jim's gain-sharing provision. The actuary may decide not to value the benefit as long as she discloses the deviation from the guidance.

In ASOP No. 1, the definitions of "must" and "should" have been combined into a single "must/should" discussion that defines each term and highlights the distinction between them. With respect to the ASOPs, "should" provides the actuary with more flexibility than "must" in deciding what course of action to take. However, the actuary should carefully review the ASOP for the appropriate deviation and disclosure language when, in the exercise of her professional judgment, she decides to deviate from the course of action that the ASOP says "should" be followed. ☐

KATHLEEN A. RILEY, a member of the Academy, is a Fellow of the Society of Actuaries and the Conference of Consulting Actuaries. She is a senior vice president and actuary at Segal Consulting in Boston and a member of the Actuarial Board for Counseling and Discipline.

JOE SUTTLIFF