ACTUARIAL STANDARDS BOARD

February 1, 2013

The Actuarial Standards Board (ASB), the standard-setting body for actuaries in the United States, is pleased to provide these comments on the Exposure Draft of the ISAP on the Valuation of Social Security Programs (ISAP SSP) for the ASC as they seek to develop a final version.

Questions from the ASC:

1. *Is the guidance clear and unambiguous?*
   - As indicated in our comments, we believe that there are a number of areas where the guidance is not clear or unambiguous.
2. *Is the guidance at the right level of detail, or should it be more or less detailed?*
   - We suggest that the guidance is so broad in certain areas that it would permit misleading and inadequate determinations and disclosures if that were politically expedient. Therefore, we suggest that more detailed requirements in some areas may be appropriate. These areas are noted below.
3. *Are there other matters that should be included in this standard on social security? Are there some included here that should not be?*
   - We suggest that the scope is too broad in that it includes programs for which actuarial expertise is not needed and for which long-term projections are atypical, for example, certain welfare plans.
   - We suggest that the scope is too narrow because of its requirement that SSPs be population-wide, which would exclude, for example, the US Railroad Retirement System.
   - We believe that sensitivity analysis is critical for work associated with SSPs, and should be required. We also suggest that guidance regarding methods for performing sensitivity analysis be added to section 3.

We provide more detail for our responses to questions 1-3 in the comments by sections below.

General Comments on ISAP SSP:

1. The ISAP appears to define SSPs in such a way that short-term welfare programs are included. In the US, such plans are normally not considered to be SSPs. While actuarial expertise may be helpful to design and administer such plans, actuarial services required to value them tend to differ from those needed to value “true” long-term social security programs, and may not be required at all. We suggest limiting the definition of SSPs to programs for which long-term projections are being performed.
2. Governments and their officials may periodically interfere in the work of actuaries on SSPs, such as by imposing requirements intended to achieve politically expedient results. We suggest that the ISAP identify the actuary’s responsibilities in this situation. We believe that there is a fundamental difference between (a) laws that are regulating private programs and (b) laws governing SSPs, where governmental units or subdivision(s) are acting as a provider. In the SSP situation, we suggest that the ASC consider requiring the actuary to report with respect to any assumption or methodology that significantly conflicts with what, in the actuary’s professional judgment, would be reasonable for the purpose of the measurement, even if the assumption or methodology is established by law.
3. We are concerned about the apparent requirement, in section 4.1.4.b., that a “balance sheet” presentation be provided when a valuation is performed. As we interpret the term, “balance sheet” means either the traditional accounting balance sheet or an actuarial balance sheet that includes the present value of future expected

contributions. In the US, neither an actuarial balance sheet nor an accounting balance sheet is used to convey valuation results for an SSP, nor is either of them required by our Actuarial Standard of Practice on this topic. Typically in the US, results of a valuation of an SSP are expressed by stating an actuarial funding requirement, which is usually expressed as a percentage of covered payroll. As a result, we suggest the requirement for a balance sheet presentation be eliminated or that other presentations of results be allowed.

Furthermore, we suggest that, in open group situations, an actuarial or accounting balance sheet may not be the best presentation and should not be required due to the following:

- The SSP financial report is generally for the benefit of non-experts. To a non-expert, the actuarial balance sheet is often more confusing than helpful.
- Is a balance sheet an informative presentation for a program such as a welfare plan that typically has only short-term projections?
- By definition, a balance sheet always balances. Will an intended user or the media be able to understand whether the SSP is adequately funded when the surplus or deficit is in mid-statement as opposed to being the bottom line?
- A balance sheet gives no indication of the end-of-period (meaning end of the projection period) financial position, which is often important information.
- What is the liability if the law limits the benefit obligations to the amount that can be provided from designated revenue sources, as is the case for Ontario's Pension Benefits Guarantee Fund?

Where open group valuations are being used, we suggest that the actuary be permitted to use presentation methods other than actuarial or accounting balance sheets.

If the balance sheet requirement is maintained, we believe the ISAP should define the term very carefully.

Comments by sections of the ISAP SSP:

Section 2. Definitions

Section 2 in general:

2.12. Social Security Programs (SSPs): With respect to SSPs in the US, this definition would appear to exclude the Railroad Retirement System, which is generally considered to be an SSP. Also, it appears to include programs that typically do not have long-term projections such as food stamps and other welfare programs.

2.13. Subsequent Event: We suggest that for practical purposes and for consistency with section 4.1.2., the ASC consider making the Report Date the cut-off.

Section 3. Appropriate Practices

3.1. Section 3.1. requires the *"consideration of all relevant features of the SSP and law."* We suggest the ISAP consider qualifying that phrase with words to the effect of "if that experience information exists and is reasonably available to the actuary."

3.3. The first paragraph of this section states that *"Neutral assumptions are such that the actuary expects that the resulting projection of the SSP experience is not a material underestimate or overestimate of the obligation."* Obligations are generally thought of to mean liabilities, but in some SSPs the necessary contribution rate to provide actuarial balance is a more important result of the valuation than any liability measure. We suggest that "obligation" be replaced with a broader word such as "result" or simply delete the clause "of the obligation."

The fifth paragraph states that *"The actuary may also reference the relevant experience of other SSPs or other countries to establish assumptions."* We suggest you consider inserting "the program being replaced, if any," after "experience of."

3.4. Balance Sheet Methodology

As noted above, we suggest that the requirement to produce a balance sheet, in section 4.1.4.b., be removed. If that is done, then section 3.4. may not be needed. If it is retained, we suggest that it be modified as noted below.

"When applicable, the actuary should choose which methodology to use to produce an SSP's balance sheet based mainly on the financing approach used." "Balance sheet" needs to be clearly defined for this context. In addition, we recommend that other presentation forms be permitted.

3.4.1. *"For fully funded SSPs (that is, where accrued liabilities are intended to be funded over participants' working years), balance sheets should be produced using a closed membership group approach, under which only current participants are considered with or without their assumed future benefit accruals."* Do such SSPs exist? In any event, it is not clear why any continuing, legislatively mandated, population-wide program should be required to be valued on a closed group basis.

3.4.2. *"For pay-as-you-go or partially funded SSPs, if balance sheets are produced, they should be done using an open group approach, under which contributions and benefits of both current and future participants are considered."* Section 4.1.4.b. appears to require a balance sheet and only gives the actuary discretion as to the methodology to create it. Yet section 3.4.2. appears to give the option of omitting a balance sheet altogether. This needs to be clarified.

3.4.3. *"Where law requires adoption of an approach for production of a balance sheet that is not in line with either section 3.4.1. or 3.4.2. as applicable, the actuary should communicate the effects of the approach required for the program in question to the intended users."* What are the actuary's obligations if the law does not require a balance sheet at all or mandates a non-balance sheet format?

<u>Section 4. Communications and Disclosures</u>

Section 4 in general:

- **Section 4 requires** a large number of items to be reported that are never mentioned in section 3. For example, the ISAP includes no requirement to calculate the items mentioned in section 4.1.4.c. and never defines the meaning of those terms. We suggest that section 3 needs to be made consistent with section 4 by adding guidance on calculations required by section 4.
- Furthermore, we believe sensitivity testing should be mandated for this area of practice.

4.1.4.b.

The stem sentence requires that balance sheet information be disclosed. As noted above, we suggest that this requirement be removed.

i. Contributions. Is this based on the contribution formula or the actuarial determination? Is there an allowance for untimely or uncollected contributions where history suggests that collection will be a problem? Do present values reflect future contributions?

ix. Actuarial deficit and funded ratio as of valuation date and other representative dates (for fully-funded or partially funded schemes). Is guidance needed as to how to calculate these items? For example, if an actuarial value of assets is used, can the funded ratio be reported based on that value or must market value be used?

xi. Market value of tangible assets/funded assets. How are tangible assets different from funded assets? In the absence of a trust fund, what assets are appropriately included? We suggest the ASC consider requiring disclosure of the asset allocation. Understanding an SSP's valuation is affected significantly by whether assets are primarily invested in securities of the sponsoring government (particularly if the market for such securities is limited) or are invested in securities for which a deep, liquid, transparent market exists.

4.1.5.f. *"Conclusions on the short-, medium-, and long-term financial sustainability of the SSP with due regard to the funding rules under the law if such funding rules exist."* Is this an actuarial function? And does it include collectability of contributions or an assessment of the realistic chance of tax rates – including general revenue taxes such as on income and sales – being raised to sufficient levels? Is it appropriate for an actuary to anticipate changes in the law to fix “errors” such as the double-indexing that was subsequently removed from the US Social Security System many years ago?

4.2. Actuarial Opinion

b. *“The assumptions used for the report are, in the aggregate and/or individually, reasonable and appropriate.”* We suggest clarifying that when the governmental unit is in the role of the provider, this requirement applies even when assumptions are established by law.

c. *“The methodology employed is appropriate and consistent with sound actuarial principles.”* We do not know the meaning of “sound” in this context and suspect most readers will not either. Would saying “the methodology employed is based on appropriate actuarial principles” be sufficient? If so, we also suggest that the actuary be required to define the basis for determining the appropriateness of the principles—e.g. this ISAP.

d. *“The SSP is financially sustainable over the period covered by the projections used for the valuation.”* This is perhaps desirable, but an appropriate statement of sustainability may require caveats. For example, any funding based on general revenues inherently requires appropriations in the future. The actuary may need to note that the SSP is only sustainable if future appropriations are made as expected. Further, some SSPs may state that benefits will only be paid if assets are available to pay them. For these plans, the actuary should value obligations assuming contributions are made as required and note that the valuation is dependent on those contributions. Other limitations on the opinion may be appropriate. We suggest that the ISAP make clear that the opinion may be based on assumptions as to items that are beyond the actuary’s control.

We hope the ASC finds these comments helpful. We would be happy to discuss these comments or any other questions the ASC may have regarding the ASB’s thoughts on this ISAP.