



27 February 2013

Social Security Task Force
Interim Actuarial Standards Subcommittee
International Actuarial Association

By email: SS.ISAP.comments@actuaries.org

Dear Sirs

Submission on Exposure Draft of ISAP on Valuation of Social Security Programs ("SS-ISAP")

The Institute of Actuaries of Australia ("Institute") is pleased to make this submission to the International Actuarial Association ("IAA") on the Exposure Draft of the SS-ISAP ("ED") and appreciates the opportunity to provide input on the ED.

Our submission is attached and provides both some general comments on the ED, as well as clause-specific comments.

Please do not hesitate to contact me, at anne.peters@actuaries.asn.au, if you have any questions on our submission.

Yours sincerely

A handwritten signature in blue ink, appearing to read "Anne Peters".

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1 GENERAL COMMENTS ON THE ED

1.1 Naming of ED

1. The Institute suggests that the SS-ISAP be renamed “Actuarial Investigations of the Financial Condition of Social Security Programs”. This would, in the Institute’s view, better reflect the broader scope of the work covered by the ISAP than merely valuations. (See, also, our comments at paragraph 10 below.)

1.2 Acceptable practices compared with ISAP 1

2. In the introduction on page iv of the ED, the following statement is made:

“This International Standard of Actuarial Practice (ISAP) applies to actuarial services performed in the context of Social Security Programs (SSPs). The intent of this ISAP is to narrow the range of practice considered acceptable under ISAP 1 – General Actuarial Practice. Where this ISAP defines as acceptable a practice which would not be acceptable under ISAP 1, it is clearly mentioned.”

3. Although the Institute notes that the last sentence in the above quoted paragraph is intended as a generic statement for inclusion in all practice-specific ISAPs, given that there are no such mentions in the ED, we suggest that it may be less confusing for users if the above statement were omitted.

1.3 International support for ED

4. In the introduction on page v of the ED, the following statement is made:

“In this regard, the IAA has decided to issue this ISAP with support within the International Social Security Association (ISSA) and the International Labour Organization (ILO).”

The Institute is unclear what is intended to be conveyed by this statement and would appreciate clarification.

1.4 Alignment of, and consistency between, the ED and ISAP 1

5. The Institute’s view is that, as far as appropriate and possible, the ED and ISAP 1 should be consistent and in alignment.
6. We note that there are at least three ways in which this might be achieved, and that these are not necessarily mutually exclusive:
 - (a) an overarching statement that ISAP 1 applies to the work performed under the ED unless expressly stated otherwise;

- (b) a section-by-section cross-referencing approach (akin to that taken in clauses 3.5 and 3.7 of the ED); and/or
 - (c) re-statement of the relevant clauses of ISAP 1 in the ED (along the lines taken in clauses 1.3 and 1.6).
7. Clearly, there are pros and cons with each approach. Approach (a), for example, simplifies the drafting required and avoids the necessity to update the ultimate SS-ISAP in the event that ISAP 1 is amended. By contrast, approach (c) offers the advantages of providing a “single source of truth” for the actuary regarding the requirements, but necessitates repetition and a watching brief for updates flowing from ISAP 1.
8. In some respects, the ED is a blend of all three approaches and, arguably, suffers in terms of consistency as a result, potentially making it confusing for actuaries. For example:
- (a) the introduction on page iv of the ED (cited at paragraph 2 above) which could be read as an “applies unless the actuary is told otherwise” approach;
 - (b) adoption by reference, as seen in clauses 3.5 and 3.7 of the ED;
 - (c) adoption by reference but with expansion, as seen in clause 4.1 of the ED; and
 - (d) ‘cut and paste’ repetition of clauses from ISAP 1, as seen in clause 1.6 of the ED.
9. Whilst the Institute favours an approach of minimising repetition and cross-references, we recognise that a number of alternative approaches are possible in terms of aligning the ED and ISAP 1 in an efficient and user-friendly manner. However, whichever approach is taken, our greater concern is that it be applied in a consistent manner. In Section 2 of this submission, we provide detailed comments on anomalies and differences between the ED and ISAP 1, and on inconsistencies within the ED.

2 DETAILED COMMENTS ON SECTION 1 (GENERAL) OF THE ED

2.1 Sections 1.1 and 1.2: Purpose and scope

10. The Institute notes that both of these sections refer to “valuations” of SSPs. Not only is the definition of “valuation” in clause 2.14 of the ED arguably inconsistent with the generally accepted meaning of the word, elsewhere the ED uses phrases such as “financial status” (clause 3.3), producing “balance sheets” (clause 3.4), “projected financial status” (clause 4.1), “financial sustainability” (clause 4.1.4d) and “long-term financial sustainability” (clause 4.1.5h).
11. The Institute considers that, consistent with our comments at section 1.1 above and paragraph 19 below), the purpose and scope clauses should make clear whether the ED covers, not only the valuation itself, but also the opinion regarding financial viability

of the SSP (hence, our preference for using the broader concept of “investigation of financial condition” in the title). If the latter is covered, then it would be helpful to refer to the concept consistently.

12. A further alternative to “valuation” which might also be considered is “financial analysis”.

2.2 Section 1.4: Applicability

13. The Institute suggests clarifying, in the opening sentence of clause 1.4, that the SS-ISAP applies to actuaries when performing actuarial services “within the scope of this ISAP”. This would avoid any confusion.
14. We note that the language in clause 1.4.4, whilst reflecting that in the Exposure Draft of ISAP 1, is not consistent with the same clause in the final version of ISAP 1. We suggest the two clauses be aligned.

2.3 Section 1.5: Reasonable judgment

15. We note that the language in clause 1.5.2, whilst reflecting that in the Exposure Draft of ISAP 1, is not consistent with the same clause in the final version of ISAP 1. We suggest the two clauses be aligned.

3 DETAILED COMMENTS ON SECTION 2 (DEFINITIONS) OF THE ED

16. Re clause 2.6(a) (Independent Expert Review): for consistency with drafting elsewhere, we suggest amending to read “Has not been involved in preparing the report; and”.
17. Re clause 2.11 (Report Date): the Institute has concerns that the phrase “substantially completes a report” is too vague and uncertain. We note that clause 4.2.1(e) of ISAP 1 (which applies by virtue of clause 4.1 of the ED) requires that a report be dated. We consider that, given this requirement, it would be preferable to amend clause 2.11 to remove any potential ambiguity or areas of dispute.
18. Re clause 2.12.2 (Social Security Programs): we suggest replacing the words “prescribed by statute” with “prescribed by law”. This would more effectively cover a range of ways in which prescription may occur – for example, by regulation – rather than merely statute.
19. Re clause 2.14 (Valuation): the Institute has already commented (at section 1.1 and paragraph 10 above) on the use and definition of the term “valuation”. If a contrary view is taken, the Institute finds the expression “formal analysis of an SSP” somewhat vague and suggests that, in the context of the instructions received by an actuary from his or her client – as well as a common sense understanding of the word – it is unnecessary to define the term.

20. Re clause 2.15 (Valuation Date): the Institute considers that the existing definition is ambiguous and would propose amending it to:

“The effective date of the analysis of the SSP.”

21. We note that a number of definitions in Section 2 of the ED repeat the equivalent definition from Section 2 of ISAP 1. Conversely, we found one instance of a term in the ED (“work”) which is identified as a defined term but is not defined in the ED, although it is defined in ISAP 1. As discussed in section 1.4 of this submission, we suggest that a consistent approach be adopted in terms of aligning the ED and ISAP 1.

4 DETAILED COMMENTS ON SECTION 3 (APPROPRIATE PRACTICES) OF THE ED

4.1 Section 3.3: Assumptions

22. We presume that the provisions of clause 3.3 of the ED supplement those in clauses 3.6 - 3.9 of ISAP 1. We suggest that this be clarified.

23. Clause 3.3 provides that “[t]he actuary should use realistic best estimate assumptions in a financial valuation of an SSP”. The Institute raises, for the Taskforce’s further consideration, the question of whether it is always reasonable to use best estimate assumptions. In some circumstances, for example, might it be more appropriate to use a “risk free” earning rate? A couple of possibilities the Taskforce might like to consider are to:

- (a) leave the existing provision as is, but also allow the actuary to choose, as a matter of professional judgment, to depart from best estimate assumptions if other assumptions would be more appropriate. This could be combined with a requirement to provide an explanation as to why the chosen assumptions were more appropriate than best estimate assumptions; and
- (b) allow flexibility in the choice of assumptions but require disclosure of the reasons for using the particular assumptions chosen.

24. Clause 3.3 provides that:

“If an actuary uses assumptions that include a margin for any particular reason, the actuary should disclose that clearly **and properly** in the report.”
(emphasis added)

The Institute considers that the emphasised wording is unhelpful. One of the very purposes of guidance such as the ED is to guide actuaries on what constitutes “proper disclosure”. Alternatively, wording such as “and in a non-misleading way” could be used.

4.2 Section 3.4: Balance sheet methodology

25. Re clause 3.4.3: In the Institute's view, more clarity around the phrase "communicate the effects of the approach required" would be desirable if possible. For example, at least two interpretations are possible under the current wording:
- (a) two valuations are required – one for the methodology the actuary would use and one for the prescribed methodology; or
 - (b) the actuary only has to communicate the effects of the approach used (namely, the approach required by law) – that is, communicate how that approach impacts the results – rather than undertaking a comparison with one or both of the approaches set out in clauses 3.4.1 or 3.4.2.

5 DETAILED COMMENTS ON SECTION 4 (COMMUNICATION) OF THE ED

5.1 Section 4.1: Specific information to be included in SSP valuation reports

26. In clause 4.1.1, we suggest amending the opening words to read as "the key provisions of the SSP" in order to avoid an excessively detailed description which may be unhelpful to the intended users.
27. We presume that clause 4.1.2(c) is intended to deal with the situation of Subsequent Events where certain additional post-valuation information may have been taken into account. If so, we think it would be helpful to clarify this.
28. In clause 4.1.4(a)(i), although we assume that the closing words "to the total population" are intended to refer to the total population of the country, it could be read as meaning 'the total population covered by the SSP'. Again, we think it would be helpful to clarify the wording further.
29. In clause 4.1.4(b)(ix), we suggest there is some potential for confusion in the structuring of the clause and that it would be helpful to restate it as:
- "Actuarial deficit and funded ratio as of valuation date and, for fully-funded pension schemes, other representative dates."
30. Re clause 4.1.4(d): The Institute finds the phrase "[a] presentation designed to provide an indication ..." somewhat unclear. The intent may be to refer to the manner in which results are presented (which might include commentary, tables, graphs, etc), but it could also be read as just a high level "indication" through a Powerpoint slide presentation. We think it would be helpful to consider alternative wording.
31. In clause 4.1.5(a), we suggest the opening words be amended to read "Reconciliation with the previous report (if any), ...", as, in the case of a new SSP, there may be no such previous report.

32. In clause 4.1.5(b), we suggest that, in the penultimate line, the word “system” be changed to “SSP” to avoid any potential for confusion.
33. Clause 4.1.5(c) addresses the “effect, if material, of any subsequent event”. We think it would assist users of the SS-ISAP if it were made clearer that the analysis under this clause might be quantitative or qualitative (the latter may be sufficient, or all that is reasonably possible, in the circumstances).
34. Re clause 4.1.5(h):
 - (a) the phrase “potential recommendations” is somewhat unclear. Assuming we have interpreted the drafters’ intention correctly, we suggest using, instead, either “Any recommendations ...” or “Recommendations, if any, ...”; and
 - (b) the phrase “to ensure” the long-term sustainability of the SSP sets an onus which, in our view, is too high. Given the periods of time involved, “ensuring” the long-term sustainability of an SSP is fraught with danger. We suggest that this concern could be addressed, for example, by either:
 - (i) using a phrase such as “to improve” to lessen the onus; or
 - (ii) retaining the “ensure” language, but including a caveat such as “on reasonable expectations regarding the SSP’s future experience,, over a time period that is, in the actuary’s opinion, reasonable in the circumstances of the SSP”.