



The Actuarial Profession

making financial sense of the future

Consultation Response **International Actuarial Association**

Exposure Draft of an International Standard of Actuarial Practice
(ISAP) on the Valuation of Social Security Programs

28 February 2013

About the Institute and Faculty of Actuaries

The Institute and Faculty of Actuaries is the chartered professional body for actuaries in the United Kingdom. A rigorous examination system is supported by a programme of continuous professional development and a professional code of conduct supports high standards, reflecting the significant role of the Profession in society.

Actuaries' training is founded on mathematical and statistical techniques used in insurance, pension fund management and investment and then builds the management skills associated with the application of these techniques. The training includes the derivation and application of 'mortality tables' used to assess probabilities of death or survival. It also includes the financial mathematics of interest and risk associated with different investment vehicles – from simple deposits through to complex stock market derivatives.

Actuaries provide commercial, financial and prudential advice on the management of a business' assets and liabilities, especially where long term management and planning are critical to the success of any business venture. A majority of actuaries work for insurance companies or pension funds – either as their direct employees or in firms which undertake work on a consultancy basis – but they also advise individuals and offer comment on social and public interest issues. Members of the profession have a statutory role in the supervision of pension funds and life insurance companies as well as a statutory role to provide actuarial opinions for managing agents at Lloyd's.

28 February 2013

Dave Pelletier
Chair, Actuarial Standards Committee
International Actuarial Association
150 Metcalfe Street, Suite 601
Ottawa
Ontario
K2P 1P1

Dear Dave

IAA - Exposure Draft of an International Standard of Actuarial Practice (ISAP) on the Valuation of Social Security Programs

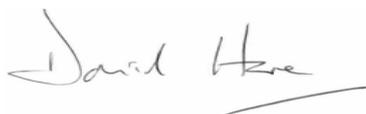
The Institute and Faculty of Actuaries (IFoA) welcomes the opportunity to provide comments on this exposure draft. We especially welcome the identification of the valuation of Social Security Programs (SSPs) as a specific responsibility of actuaries and a distinct role for actuaries.

We are assured that the draft makes significant progress in setting out the principles of valuing SSPs. However, we believe there could be greater clarity for actuaries involved in that area of work by amending the draft in the respects we propose.

We recognise that the results of most, if not all, SSP valuations will be set within a political context. Consequently, it is paramount that the independence of the actuary is established, ensuring that the actuary's ability to provide appropriate valuations is not limited by external pressures. The IFoA believes that objective would be achieved by means of a clearer emphasis on disclosure within section 1.1 of the ISAP.

We have enclosed an Appendix containing our suggestions and comment on specific sections of the Exposure Draft that we hope will help finalise this document. We would be more than happy to discuss any, or all, of these comments. If you wish any clarification, please contact, Philip Duggart, Policy Manager at the IFoA (philip.duggart@actuaries.org.uk).

Yours sincerely



David Hare
President-elect
The Institute and Faculty of Actuaries

Appendix – Specific Comments on the Exposure Draft:

- 1.4** The possibility of omitting some content because of the expectations of the principal is not always appropriate. As the results of most SSP valuations will be published and will be used for policy making, any omissions should be identified and explained; otherwise the results could be misinterpreted (maliciously or accidentally) by users of the valuations. Stating the detail of omissions would also be consistent with 1.3.3.

This section also requires a definition of “principal” and “affiliated party”.

- 2.12** The draft requires some further explanation as to what “ultimately responsible” means. Different jurisdictions may operate programs under statute, but without any government guarantees. The interpretation of ultimate responsibility in such cases may not be consistent.

- 3** As noted in our general comments, the IFoA believes that the wording around what actuaries disclose should be stronger. Specific examples are:

3.2 – The actuary should use data, rather than consider using it.

3.3 – The actuary must disclose any margins in assumptions, rather than should. In this section, work done in analysing experience is likely to be undertaken in more than one area, so “analysis” should be plural.

- 3.4** The IFoA believes there should be clarification around the term “balance sheet methodology”, particularly in relation to unfunded or PAYG schemes.

We believe there should be specific reference to the use of cashflow projections, highlighting the sensitivity of present value valuations to the discount rate used. This is an area where the independence of the actuary is crucial.

The IFoA is also uncertain that a closed fund would always be appropriate for fully funded SSPs. The circumstances under which a closed fund approach would be appropriate should be explained in more detail.

- 4.1.3** The uncertainty within each assumption should be disclosed so that the risks around the valuation results can be better understood.

Dependency ratios will be more difficult to assess, particularly as maturing SSPs provide greater flexibility around retirement ages (also in 4.1.4). Historical dependency ratios may be of limited use.

- 4.1.4** In some jurisdictions, the term “market value” may be open to interpretation. Where markets are deep and liquid, the market value is readily accessible; but this is not always the case in less developed economies. “Patriotic” investment decisions can lead to a distorted value of assets that would not reflect what would necessarily be realised on disposal. This would also remove the requirement to include 4.1.4 b xiii. We would prefer to have greater clarification about what “market value” means.

The term “reserve adequacy level” should also be added to the section on results, with a definition.

- 4.1.5** The analysis of the results “should” include all of the items listed; unless the actuary believed them not to be material (see 1.4 above).

Any analysis of results should include a discussion of the uncertainty of the results.

4.2 As set out in our initial comments, the consequences of the actuary's work in completing SSP valuations could be misinterpreted. The actuary should report the importance of an assumption not holding and the resulting consequences. Including this type of statement would reinforce the independence of the actuary and would be more helpful to users of the results of SSP valuations.