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## Session 29IF ASOP Standards, Not AESOP'S Fables

**Track:** Pension  
**Moderator:** LINDSAY J. MALKIEWICH  
**Panelists:** HEIDI DEXTER<sup>H</sup>  
SUSAN E. HEDRICK  
**Recorder:** LINDSAY J. MALKIEWICH

*Summary: This session intends to update the audience on the progress of the following current standards:*

- *Demographic Standard*
- *Domestic Relations Standard*
- *Asset Valuations*
- *Cost Methods Standards*

*This session discusses how we might better proceed in responding to ongoing items of interest. Furthermore, the workings of the Pension Committee are addressed and discussed along with new standards, partly driven by current governmental activity.*

**Mr. Lindsay J. Malkiewich:** The panelists are Heidi Dexter, a consulting expert from William M. Mercer and Susan Hedrick, a consulting actuary from Watson Wyatt Worldwide.

The first topic will be the Actuarial Standards Board's (ASB) structure and standards of practice. Heidi will lead that discussion. She'll also talk about some current pension standards that are currently being worked on by the Pension Committee of the ASB. Susan will then talk about Actuarial Standard of Practice (ASOP 34), the Domestic Relations Standard that was released in 1999. I'll follow with ASOP 35, the Demographic Assumptions, released in the summer of 1999. Then Heidi will discuss the Benefit Illustration Standard, which is being worked on now by the Pension Committee and is being done in response to some of the hot issues on the disclosure of various illustrations..

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<sup>H</sup> Ms. Dexter, not a member of the sponsoring organizations, is a Consulting Actuary with William M. Mercer in Seattle, WA

**Ms. Heidi Dexter:** Let's talk a little bit about how the standard-setting process works and the people who are writing these standards.

The Actuarial Standards Board is an independent entity under the American Academy of Actuaries. The members of the ASB are appointed by the council of presidents and the presidents-elect of the five U.S. actuarial bodies: the Casualty Actuarial Society, the Society of Actuaries, the Conference of Consulting Actuaries, the American Society of Pension Actuaries and the American Academy of Actuaries. The nine members include two representatives from each of the major practice areas: two pension, two health, two life, two casualty and then the ninth person is usually life or health, and it varies a little bit. The ASB reports to the Council of Presidents, and it is supported by the Academy Staff and the Director of Professionalism, Lauren Bloom. The standards board doesn't actually do the drafting of the standards. That's done by the operating committees and task forces. The difference is that an operating committee is essentially permanent, the members come and go, but the committee is established and ongoing.

The task force is established for a specific purpose and then it's disbanded at the time it has completed its mission. The standing committees are the Casualty, Health, Life and Pension Committees, which are working on standards and specific practice areas. The General Committee creates standards in areas that span all practice areas. Some are the data quality standard and the standard on expert testimony. It is currently working on standards on actuarial communications and use of generally accepted actuarial principles and practices. So the standards that the General Committee works on effect all the practice areas. We have one active task force, and it is the Retiree Group Benefits Task Force. It is in the process of rewriting ASOP 6 and Actuarial Compliance Guideline No. 3. So when its work is done, that committee will be disbanded. Other task forces that have done work in the past are the Long-Term-Care Task Force and the Social Insurance Task Force. Those are the people who actually do most of the drafting. Some of the committees have set up subcommittees to work on specific standards of practice in their practice area.

I'm going to focus mostly on the Pension Committee since this was billed as a Pension session. There are approximately ten members, although it goes up and down from time to time. I think we've had as many as 14 members and as few as eight in recent years. We try very hard to get a broad cross section of the practice. We have small plan practitioners, large plan practitioners, and people who work on public plans and multi-employer plans. We also have a range of different employers from small to large consulting firms, insurance companies, and government agencies. The Pension Committee recommends and develops new pension standards of practice, and it continually monitors the existing pension standards to determine when they need to be updated. It provides input to the ASB and occasionally to the Actuarial Board for Counseling and Discipline (ABCD) when it has questions on standards and how they're intended to work. The standard setting process is done in three phases.

The first one is the proposal and initial development of the standard. Second is the drafting and exposure process. The third and final stage is adoption. So the

process all starts when somebody decides there is a need to have a standard in a particular area and anybody can come forward with a suggestion for a standard. If there is a particular aspect of pension practice where you feel you need more guidance and there is no standard, you can write a letter to the ASB suggesting that a standard needs to be adopted in that area. The ASB would work with the committee to determine the need for the standard and whether or not go forward with the drafting of it.

So the first step is to prepare a formal proposal for a standard, which is typically one page. First, what practice area is of concern? Then, why is the standard needed, and what is the time frame for developing it? The ASB will evaluate that and determine whether it wants to go forward. If so, it assigns that to a committee to do the drafting.

The first thing the committee does is prepare a summary of the standard, which is taking the proposal, and fleshing it out a little more. We determine what topics we intend to cover. It is just sort of an outline. That's typically published in the "Actuarial Box Score" which comes out quarterly, usually in a mailing with an update. So when a new project is being started, the first place you'll see it is in the "Actuarial Box Score." It will also usually tell you who is chairing the drafting committee and who to get in touch with if you want more information as the standard is developed.

Then the hard work starts. The committee drafts the proposed standard, but that can take as much as nine months to two years. We usually start with conceptual discussions, such as what are the issues and what are the best practices. As the last committee chair put it, we start by throwing soft objects at one another and we end up moving up to hard objects. There is eventual exhaustion, compromising and capitulation. Finally, we come up with a draft standard. That goes to the ASB, which will review it and either send it back to the committee for more work or approve it for exposure. If exposure is approved, then the ASB prints those little pale colored booklets that would go out with the next update. It also is posted on the Web site. That's usually the first place it will be available because it goes up on the Web site as soon as it's finalized. The printing process can take anywhere from three weeks to six weeks. When that goes out there, will be a comment deadline on the exposure draft. So between the time they receive it, within that deadline, actuaries review it, and write comment letters which they send back to the ASB. Then the committee will meet to begin reviewing the comment letters. We ask people to try to send your comments in by e-mail, so they can be in attached documents. It makes our job easier.

One of the first things a staff person will do is take the comment letters and cut and paste them by section. Any comments on Section 3.2 will all be collated together so you can get a picture of what people thought about that particular section. If we have it in electronic form, it's a lot easier for us to do that. The committee does take comment letters very seriously. I really urge people to review exposure drafts and write comments because we have to assume that you fully agree with it unless you write us a comment letter and tell us something different. Even if you fully

agree with it, it doesn't hurt to write a comment letter that says you agree with it and think it's ready to be adopted.

As the committees are reviewing the comment letters, they will determine where the comments suggest the need to change the standard or where the committee will just respond to the commentator, "Here is the reason we drafted it this way and we're not going to change it". It will appear in the appendix to the final standard or, in the next exposure draft, there will be a summary of all the comments that were received and how the committee acted. If there are either major changes to the draft or any change that represents a materially higher standard than what was proposed, then we're required to re-expose. That goes back and we start the whole process all over again.

If there are just minor changes and the standard is no higher than what was proposed in the exposure draft, then it can be submitted to the ASB for adoption as a final standard. We have had a few things go to two exposure drafts, and some have gone to three, so it sometimes does take us a few tries to get it right, but we hope, in the end, the due process and the exposure process does improve the final product.

Once the standard is approved, the final standard of practice is printed and distributed. It's also posted on the Web site as the final standard. We hope actuaries apply that ASOP in their practices. Then the committee will continue to monitor that standard to determine whether it needs to be amended, expanded, or even eliminated, which could be caused either by new or emerging developments within the actuarial field or by external forces such as new laws or new accounting standards that might mandate changes to a standard of practice. When the need for change is identified, the committee will prepare one of those proposals to the board describing the need for the change. We'll go back to the whole exposure process all over again. That's how it works. We thought it might be worth just having a little example of why it's important that you know about the standards and comply with them in practice. So I'm going to turn it over to Lindsey and Susan.

**Ms. Susan E. Hedrick:** We will do a little roleplay. It actually comes from an actual case for which my husband was an expert witness. I'll give a little background. It's a situation with a multi-employer plan where the employer has withdrawn and is challenging the withdrawal calculation.

**Mr. Malkiewich:** Ms. Hollis Perfect, could you identify this for me?

**Ms. Hedrick:** It's the Code of Professional Conduct of the American Academy of Actuaries.

**Mr. Malkiewich:** Could you describe in your own words what this document is?

**Ms. Hedrick:** It's all the rules that the members of the American Academy of Actuaries are supposed to follow in their work.

**Mr. Malkiewich:** Ms. Hollis Perfect, are you a member of the American Academy of Actuaries?

**Ms. Hedrick:** Yes.

**Mr. Malkiewich:** Are you subject to this Code of Professional Conduct?

**Ms. Hedrick:** Yes.

**Mr. Malkiewich:** Do you follow this code in performing your professional duties as an actuary?

**Ms. Hedrick:** Of course.

**Mr. Malkiewich:** Ms. Hollis Perfect would you please turn to page two of that code and read Precept No. 5?

**Ms. Hedrick:** "An actuary shall, in communicating professional findings, indicate clearly that the actuary is the source of the findings and is available to provide supplementary information and explanation."

**Mr. Malkiewich:** Thank you. Can you explain in your words what this means?

**Ms. Hedrick:** It means actuaries should take responsibility for their work and also disclose if they've relied on work of others and not take responsibility for that.

**Mr. Malkiewich:** Do you follow that precept in performing your professional duty as an Actuary?

**Ms. Hedrick:** Yes.

**Mr. Malkiewich:** Now let me hand you Plaintiff's Exhibit #128. Would you please identify this document?

**Ms. Hedrick:** Yes. This is the report that my firm prepared for XYZ Company showing their alleged withdrawal liability from the local 428-pension plan.

**Mr. Malkiewich:** Ms. Hollis Perfect, would you know who the author of this document is?

**Ms. Hedrick:** I'm the author.

**Mr. Malkiewich:** You wrote this? Ms. Hollis Perfect, could you show the court where in this document your name is shown? Please feel free to take your time. We've got something here, you need to refresh your memory?

**Ms. Hedrick:** It doesn't show the author.

**Mr. Malkiewicz:** Ms. Hollis Perfect, aren't you required by your Profession's Code of Professional Conduct to identify yourself as the author to take professional responsibility for your work?

**Ms. Hedrick:** I guess I forgot.

**Mr. Malkiewicz:** You forgot? What did you do in this case?

**Ms. Hedrick:** I delivered the report to the client in person. They were well aware that I was the author.

**Mr. Malkiewicz:** During the discovery process, this document was faxed to my office. The only person identified in the entire fax was "Ima Greathelp" who happened to be named in the fax cover sheet. Ms. Hollis Perfect do you know Ima Greathelp?

**Ms. Hedrick:** She is my administrative assistant.

**Mr. Malkiewicz:** Is Ima Greathelp the author of this document?

**Ms. Hedrick:** No.

**Mr. Malkiewicz:** Is Ima Greathelp a member of the American Academy of Actuaries?

**Ms. Hedrick:** No.

**Mr. Malkiewicz:** What was Ima Greathelp's role in producing this document?

**Ms. Hedrick:** She simply faxed the document to your office.

**Mr. Malkiewicz:** Why didn't the document that was faxed to my office identify the actuary responsible for the report?

**Ms. Hedrick:** I forgot.

**Mr. Malkiewicz:** You forgot. You forgot to follow the Code of Professional Conduct in your profession in preparing a document for this court. Now Ms. Hollis Perfect, doesn't your employer have a peer review policy?

**Ms. Hedrick:** Yes.

**Mr. Malkiewicz:** Did you have this document peer reviewed?

**Ms. Hedrick:** Yes.

**Mr. Malkiewicz:** By whom?

**Ms. Hedrick:** Mr. H. Ed Guy, another actuary in our office.

**Mr. Malkiewicz:** Is Mr. H. Ed Guy a member of the American Academy of Actuaries?

**Ms. Hedrick:** Yes, I believe he is.

**Mr. Malkiewicz:** Is Mr. H. Ed Guy also subject to the Code of Professional Conduct in the American Academy of Actuaries?

**Ms. Hedrick:** Yes.

**Ms. Dexter:**... and so on and so forth. Before they're done they'll pull out ASOP 4 and try to catch you on every point where you did not fully satisfy ASOP 4. Then they're going to pull out ASOP 27 on economic assumptions and try to see if you have had any lapses in practice with respect to ASOP 27. They'll ask a lot of questions, which might be designed to make you look like you intentionally violated the standards of practice in order to make it harder for the plaintiff to prove their case against you. So if you've managed to come across as merely negligent rather than a total sleaze ball, your lawyer may try to rehabilitate the witness by explaining mitigating circumstances, and so on. However, it would have been a whole lot easier to just comply with the standards of practice in the first place.

Let's go through a quick overview of standards of practice you need to worry about. In the pension area, the final standards of practice that are out there are: ASOP 2 on *FAS 87 and 88* communications; ASOP 4 on measuring pension obligations; ASOP 27 on selecting economic assumptions for measuring pension obligation; and ASOP 4. Susan is going to talk about ASOP 4 on actuarial practice concerning retirement benefits and domestic actions. Lindsay is going to talk about ASOP 35 on setting demographic assumptions, which is another one that was issued in December.

There are two actuarial compliance guidelines. Number 1 is for *FAS 87* and Number 2 is for *FAS 88*. There is some confusion in the profession as to what a compliance guideline is and whether it's a standard or just a suggestion. In fact these are standards of practice but they are standards for compliance with some outside set of requirements like an accounting statement. We're in the process of revising all those. We will eventually eliminate all the Actuarial Compliance Guidelines (ACGs) going forward to the extent we're issuing standards for compliance. They'll have a regular ASOP number. Somewhere in the title it will say "For Compliance With," and it will identify what the outside requirement is.

The Pension Committee is currently working on three standards. The Projected Benefit Illustration Standard, which I'm going to talk about a little later, is on a fast track so we've set aside the other two standards that the committee had been working on until that one gets into exposure draft stage. The other two standards are Asset Valuation Methods and Actuarial Cost Methods. Then, once we get those wrapped up, the next thing we're going to look at is revising ASOP 4, Measuring Pension Obligations and the Actuarial Compliance Guidelines 1 and 2. There are a few other standards that are outside the pension realm, but you still need to be cognizant of them.

If you do any *FAS 106* work or other retiree medical work, you should be aware of ASOP 6 and Actuarial Compliance Guideline #3. These are the ones that are in the process of being revised by the Retiree Group Benefits Task Force. If you do any expert witness work, you might be subject to ASOP 17 on expert testimony. We're all dealing with our client's auditors who have to be cognizant of ASOP 21, the Actuary's Responsibility to the Auditor. In everything we do, ASOP 23 on Data Quality will apply. Of course, all members of U.S. actuarial organizations are subject to the Code of Professional Conduct on all work that they do anywhere in the world. In addition, the Qualification Standards for Public Statements of Actuarial Opinion apply to work done in the United States.

Then there are two interpretative opinions 3 and 4 on applying generally accepted actuarial principles and practices and on actuarial communication. The general committee is in the process of rewriting those standards of practice. At least the communication standard is being worked on in conjunction with the changes for the Code of Conduct. You should have recently gotten a second exposure draft for the Revised Code of Conduct. It covers some of the same territory, so we have to make sure those two things are in sync. So now I'm going to turn it over to Susan to talk about ASOP 34.

**Ms. Hedrick:** ASOP 34 was adopted last September and deals primarily with actuarial evaluations of retirement plan benefits for property settlement purposes. It's effective for engagements starting on or after March 31, 2000. The standard is very specific. It doesn't matter when the work is being done. It has to do with when the actuaries first engage to perform the work and if that's on or after March 31, 2000, then the standard does apply to you. It was developed at the request of the Actuarial Board for Counseling and Discipline. It received a number of complaints at the same time. In two of the complaints, actuaries were referring each other, so that is why the standard came about.

We're going to break into a couple of small groups. What has happened in this example is that a participant in a retirement plan, Mr. Sam Pool, asked his plan administrator for some information because he is going through a divorce. The plan administrator called the plan's actuary. The plan's actuary prepared this communication and sent it to the Plan Administrator and the participant and now the spouse has a copy of it. The spouse has decided to hire her own actuary, which is you. We want to get your opinion of this piece of communication. So what we'd like to do is break into a group and have you come up with a list of a couple of questions, comments, concerns, or issues that you would have with this piece.

**Ms. Hedrick:** All right. How did the groups do? What questions or concerns do you have about this valuation?

**From the Floor:** We need more information.

**Ms. Dexter:** What information do you need?

**From the Floor:** We need the plan formula.



**Ms. Hedrick:** So you need the plan formula, early retirement provisions, forms of payment, and information about the spouse.

**Ms. Dexter:** What information do you need about the spouse?

**From the Floor:** When did they get married?

**Ms. Hedrick:** Why is the date of marriage important?

**From the Floor:** If she married him six weeks before the divorce, she doesn't necessarily have a right to have the 23 years of pension.

**Ms. Hedrick:** So you need the date of marriage to determine how much the benefit is?

**Ms. Hedrick:** Do we need to clarify what this is for?

**Ms. Dexter:** I'll clarify a point here. There is no domestic relations order (DRO) at this point. This is for a property settlement. The pension might be traded off against the house, and against the car, or there might ultimately be a DRO if they decide to divide up the pension. At this point, this is not a DRO assignment.

**From the Floor:** It seems to me that there are not enough facts given here to determine whether somebody did something right or wrong. I mean you don't know what the assignment was or what the previous communication was that led up to this

**Ms. Hedrick:** I guess that raises one key question. What other communication has there been?

**Ms. Dexter:** It's also true that the actuary in this letter doesn't state what his role is or what his engagement was.

**From the Floor:** No matter what you're communicating, you need to know who asked you to do it and why.

**Ms. Hedrick:** Identify who you're performing the work for? Good job.

**Ms. Dexter:** Who is the client?

**Ms. Hedrick:** Did you have some comments about the assumptions?

**From the Floor:** It seems like the assumption is not required, so you still might want to hedge a little bit.

**Ms. Hedrick:** So additional information about the assumptions used and why and alternatives.

**Ms. Dexter:** I think that leads to a very good point, which is, what did the plan's assumptions have to do with this?

As we said, there might not be anything paid from the plan to the spouse. What they're trying to decide is how to carve up the house and the car and other things. If somebody else has picked those assumptions you should be careful to indicate who that somebody was?

**Ms. Hedrick:** Let's move on. We have ASOP 34, which gives some guidance on actually preparing this type of information for settlement purposes.

**Ms. Hedrick:** Let's look at what the standard tells us to do. Identify the client. It could be the plan administrator, the covered party, the spouse or even the court that requested information from you. Disclose any actual or potential conflicts of interest. There could be a conflict if you are the plan's enrolled actuary. The group didn't raise that point.

**Mr. Malkiewich:** So you heard a rumor that some firms have ceased producing information on the DROs because of the conflict of interest question?

**From the Floor:** Yes.

**Ms. Dexter:** It's my understanding that Hewitt has taken the position that they will not do these calculations. I do not know of any other large firm that has taken that position. At Mercer, we're taking the position that we will not do the work on behalf of individuals, but if a plan sponsor asks us to do this, we will do the work. Although we're not claiming that it satisfies the standard. In fact, we have a deviation clause that states we do not reflect jurisdictional specific requirements, and we urge the participant and spouse to hire their own actuary.

We're only doing it as a service to the plan administrator. We're not doing it on behalf of participants. That's up to the participant to determine. We're urging the participants to hire their own actuary.

**Ms. Dexter:** We're requiring that they give numbers at the earliest, most valuable, and normal retirement age, assuming immediate termination and assuming continued employment. I think we cover a pretty wide range but it's up to them to pick the number.

**From the Floor:** So they have to pick the number?

**Ms. Hedrick:** Has your concern been that an actuary has been given one specific number and the person uses it?

**From the Floor:** Sure.

**Ms. Hedrick:** That's exactly why the standard was put together. I think as we go through, we'll see that it addresses a lot of the concerns that you have.

**Ms. Dexter:** If it does not reflect jurisdictional requirements, it is not in compliance with ASOP 34, so there is a deviation statement in there.

**From the Floor:** Does it say that?

**Ms. Dexter:** Yes. There is a deviation statement in there that says we have not reflected jurisdictional requirements; therefore, this valuation does not meet generally accepted actuarial principles and practices.

**From the Floor:** I have a question about something you said, Heidi. You said that Mercer would like the plan participants to find their own actuaries. What if a next door neighbor or somebody else who doesn't work on that account calls Mercer and tries to hire another Mercer actuary?

**Ms. Dexter:** Mercer will not work for individuals; it only works for the plan sponsor.

**From the Floor:** If a lot of the large firms take that stand, what course of action are we going to take?

**Ms. Dexter:** There are still a lot of actuaries out there who do work on behalf of individual participants.

**Ms. Hedrick:** Let's get back to the presentation. You should define the nature and the scope of the engagement in the communication. The purpose of this communication is to provide some information for the spouse or for the participant? The standard cautions about the unauthorized practice of law. For example, it would be inappropriate for actuaries to render an opinion as to whether a draft order is valid in a particular jurisdiction. It should be left to attorneys; on the other hand, actuaries can look at draft orders and determine whether the benefits would fit with the plan provisions or if they're definitely determinable benefits. Of course, it's important to be familiar with the applicable law, including case law. In performing the actuarial valuation, there are a few requirements. First, you need to collect all of the necessary information. You need the plan information, information about the participant, and the covered spouse, and information about the measurement date that you're going to be using for determining the present value. You need to select an allocation method. That's the method for determining how much of the benefit is attributable to the marriage.

**Ms. Hedrick:** There are allocation methods that are discussed in the standard. One is the direct facing rule that looks at how much was earned during the marriage. You look at how much the participant had on the date of marriage and how much the participant's benefit was at the date of separation. Then the fractional rule takes the participant's accrued benefit and determines the marriage portion by using service or pay or another method. It's important to take into account age or service-related benefits.

The question came up in our example about early retirement subsidies; for example, if someone is currently age 60 and you know the plan offers unreduced

benefits at 62, how do you want to reflect those subsidized benefits in the evaluation. The standard says there are two ways you can do that. You can assume either the participant terminates immediately or the participant continues to remain employed and becomes eligible for those benefits. But it is important in a communication to say which method you used and to discuss the financial consequences of either method.

In selecting assumptions, you want assumptions that are consistent with each other and individually reasonable. This should be something with which you're all familiar. You also need to reflect facts and circumstances. That refers to the plan circumstances and provisions and possibly some objective information you know about the covered party and the spouse. Plan assumptions generally aren't relevant when you're determining benefits for use in the divorce proceedings. That doesn't mean you can't use plan assumptions, but they shouldn't be used automatically.

The next point is a pretty big one. It has to do with being consistent with your previous valuations. If you're doing something for the participant this week, and then the next week you're doing something for the spouse, the standard prevents you from using different assumptions. That point is really critical for the credibility of the actuarial profession. Finally, whatever you do, make sure that it's communicated fully. Here is an example of the allocation methods. For example, if you were looking at the accrued benefit, and you wanted to use the direct-tracing method, you would take the \$26,496 that this participant had earned at age 54. We're saying that's the allocation date. This person was married at age 34 when the accrued benefit was \$1,500. So by using that method, we can say that the portion earned during the marriage is \$24,996. Alternatively, you might use the fractional rule, and if you based it on service, in this example, the person had four years of service at the date of marriage. He now has 23 years, so the ratio of the benefit would be \$21,888. By using two methods that are okay by the standards, we're coming up with two different answers.

**From the Floor:** I had several people ask me, whether ASOP 34 significantly discriminates against the solo practitioner? The solo practitioner is stuck working for either one of the two parties in a marital dissolution. If he simply had a second person working for his firm he can do it one way and have another person do it the other way. It would make the attorneys far happier.

**Ms. Hedrick:** The question is, does this discriminate against sole practitioners because if you have more than one person in the office, one person can be working for the participant and one person can be working for the spouse?

**From the Floor:** Yes.

**Ms. Dexter:** In the view of the ASB and the committee, it does not discriminate. I think there are couple of issues to keep in mind. I think it's important for an actuary to make peace with what they think is an appropriate method for valuing the benefits that are attributable to the period of marriage, regardless of which party you're representing. The whole issue in all these ABCD cases is one method

for the participant and a different method for the spouse. Even the actuary is practicing that way. On Monday he's representing a spouse and he's using direct tracing and assuming continued employment. The next day, he's representing the participant and using the fractional rule, and assuming immediate termination. Soon the lawyers are going to figure that out and pick him to pieces on the stand by asking why he used this method one day but used another method on a different day. Soon he's not going to be doing any work in the practice. I think that actuary needs to make peace with the method. I think flip-flopping based on who you're representing, is not generally viewed as an appropriate approach to take in expert witness work. You're supposed to be an objective expert.

**From the Floor:** I don't think it's not in there directly. The reason I think that is because I was looking for the answer to that question when it came out, and I couldn't find it. I was a little frustrated. It seems to me that is a major point that's made at every turn. My question was, so why don't we just say that. It's like we're afraid to say it, but that's what we're doing.

**Ms. Dexter:** Section 3.3.7, which is the one on consistency, does have the following statement: "The actuary should not select different dates, methods or assumptions that the actuary would ordinarily use solely to accommodate the litigation position of the actuary's client"

**From the Floor:** If you're going to put out something which merely presents several different possibilities, it seems that you're passing the buck again. As professionals, if we're asked what the value of something is, and if we put out a number of different alternatives for the client to determine which value is appropriate, we've almost abdicated our duty.

**Ms. Dexter:** The issue pertains to whether the actuary is abdicating his or her professional responsibility by showing a range of values. I think different actuaries take different positions. I do know some people who always give a range and they explain it by saying, "I have no idea when Jo Smith is going to retire. All I can tell you is that if he retires at Time A, this is what his benefit will be worth. It's up to Jo Smith and ex-Mrs. Smith or whoever to figure out what is a reasonable value." Other people are willing to look at the facts and circumstances and come up with a single number. I think both approaches would be acceptable under the standard.

**Ms. Hedrick:** Let's see if the following example answers the questions that we raised earlier. I'll take a look at this quickly. There are key results at the very beginning and they list, as Heidi mentioned earlier, different possible amounts using either an immediate termination assumption or assuming the participant continues to work. This would take into account various retirement assumptions. Notice that the results are applicable for the state of Nevada.

**Ms. Hedrick:** There is the actuarial certification and all the data that are used in the valuation and the source of the data. Nobody raised that question earlier. A summary of the plan provisions and the actuarial basis and assumptions are next. Finally, there are details of the calculation. The idea behind this is that another actuary should be able to take this and duplicate the work that you've done and be

able to make an objective opinion of the work you've done. In closing, I want to say that we talked a lot about the process for this particular standard. We also talked a lot about the process of determining the present value in a domestic relations action. The standard also has a lot of information if you participate in adversarial proceedings, and if you're an expert witness. If you are reviewing QDROs, then you also want to look through the standard because it does have some information that would apply to you.

**Ms. Annie B. Switzer:** I have one more question about ASOP. Large firms that do work with large companies that have multiple locations can say they are not going to let individuals hire our firm to do these calculations. How do you know if an actuary that works for your company in some other city will accept an assignment outside of the scope of their employment with your firm to do a calculation for a participant.

**Mr. Malkiewich:** If an individual in a firm accepts an assignment outside of the firm, I think he would have some conflict of interest disclosing that he would have to care of with his own firm, before he can take on an assignment. I understand that it is done. People who work in various industries will take on an assignment from a friend whom they happened to know. but technically speaking, they really should disclose that particular endeavor to their firm before they take on that assignment. With this standard, we're saying that this definitely should be done by the professional actuary.

**Ms. Switzer:** In other words, if I'm out in Ohio and a friend or a neighbor asks me to do something, I should go to my office and search a national database to see if that employer is a client of my firm.

**Ms. Malkiewich:** Each firm has its own reporting requirements as to how you should disclose a potential conflict of interest. That potential conflict of interest should first be disclosed to your firm. I believe you should get direction from your own firm as to whether you should say yes or no to that potential assignment.

**Ms. Dexter:** If you decided to take the assignment on, and if the firm was a client, I think you would have to disclose to the individual you're representing that there is a conflict of interest. Or you can find somebody else in your community that you think does that type of work well and just make a referral.

**Mr. Malkiewich:** That's a very good point. My portion of the talk is on demographic and other non-economic assumptions, which is ASOP Number 35, which was adopted in 1999 after more than five years of work. As Heidi stated, some go through two or three exposure drafts. I think we went through only one exposure, which is actually pretty good. It is effective for measurements from September 15, 2001 on forward.

The assumption selection process is what we have set up in the assumption and in the demographic standard. Paragraph 3.3 has a selection process to determine assumptions for retirement, termination, turnover, optional forms of benefit, a retirement subsidy, disability and the like. How should you go about choosing

them? First, you identify the types of assumptions that you would need. In doing that, you might want to look at the purpose of your measurements, the provisions of the plan, characteristics and the obligations of your particular assignments and whether it is or is not material. In a single life plan, mortality might not even be an issue. Disability probably is not even a question.

Once you've identified the assumptions that you might need, you take a look at the assumption universe. When we talk about an assumption universe, we talk about all the tables and the experience studies. This would be whatever might exist, not only in your own plan or in your company but in the industry as a whole. With respect to mortality, you would look at all published tables all the way up to the RP 2000, your own past experience and also your as well as any governmental type agencies or publications that would give information as to what other mortality assumptions are out there.

After the assumption universe, consider the assumption format, which can use a point estimate or range of ages, rates, durations, durations and age, male, female or unisex. You then select the assumptions that you want to use. What are the purpose and the features of the plan that you're trying to follow? Make sure the experience you're choosing is appropriate for your plan. Small plans would probably have very different experience from large plans. Blue-collar plans can have different experience from white-collar plans. The RP 2000 Table will be explaining some of these differences. Turnover is very different for the small plan vs. a large plan. All these things should be looked at in regards to the actual assumptions that you select. You might want to look at your human resource division policy. Is there an ongoing pattern of window programs? Is there a downsizing environment in the general geographic area of your employer? A given plan located in the heart of no man's land vs. the same size plan in the middle of a large urban area would have very different experience with respect to mortality, turnover, salary scale, and other economic assumptions.

Then, when you've gone through all of that, and you identified the assumptions that you're using, you should determine whether your assumptions are reasonable. Is each one individually reasonable? Make sure that they appropriately model the contingency and that you do not anticipate significant accumulated gains or losses over the measurement period. While we're doing an annual valuation, it does not necessarily mean that we are anticipating that this mortality table will be only applicable for this coming year. Over the measurement period, gains or losses should not be significant, and if they are then maybe you should recheck and rechoose whatever you're actually going to be using. Let's discuss some of the considerations that are used in conjunction with the selection process that we just spoke about. With respect to the retirement assumption, rates for large plans seem to be very appropriate and almost a must. A large plan is relative to everybody, but if the plan has over 500 employees, I would think that there would be a wide range of retirement ages, not just a single age even though the plan probably gives the highest benefit in dollar terms, at normal retirement age.

Consider mortality improvement. Mortality has been improving for many years. We don't see it stopping at this point. Using today's rates of mortality, the

expectation of life may be 75 to 80 years. In 20 years time I believe that the life expectancy would be longer. Therefore, if your mortality assumption does not provide for longer life expectancies in the future the you may be understating the actual cost of the plan.

Administrative expense, depending on the size of the plan, might be a very high component. The assumption possibly should be made and certainly should be considered. There are also optional forms of early retirement subsidy to consider. I'm going to take a little poll. How many people have plans that provide an age 55 benefit which is 50% or more of the normal retirement benefit at age 65?

Let the record show that about half of the audience said that their plans have an age 55 benefit of 50% or more, which is a relatively subsidized early retirement benefit on an actuarially equivalent basis. Ignoring that subsidy would probably not be appropriate. I'm sure there are optional forms of benefits. The single life table and the joint survivor benefit would be subsidized the same way. If you only chop off 5% of the single life benefit pay that might be subsidized as well, especially depending on the ages of the participants involved. Did you have a question?

**From the Floor:** What if a plan has multiple provisions for retirement? For example, take the QDRO we looked at earlier. The plan provides for reduced benefits at 55 under any circumstances and unreduced benefits under Rule of 85. Does that require you to use at least two sets of early retirement factors—one for those people eligible for unreduced and those eligible for reduced?

**Mr. Malkiewich:** I'm not sure. It sounds like you might want to consider that

**Ms. Dexter:** It also gets at the issue of what your assumption format is. In that case, the provision of the plan and the nature of the early retirement reduction depends on age and service. You might want to have a retirement assumption that depends on age and service instead of just an age-related assumption or a point assumption.

**Mr. Malkiewich:** I'll just quickly go through the do's and don'ts. Do consider mortality projection; don't just dismiss it out of hand. Reevaluate the appropriateness of every assumption you might choose. Don't automatically dismiss it because it might be immaterial. Several immaterial assumptions, when they're combined together, might be material. Do address all assumptions. Don't select them just because they're easy to apply. Don't ignore subsidized optional forms of benefit if they are material. Finally, we have administrative expenses. They probably should be used, especially if they make up a large portion of the expenses.

**Ms. Dexter:** I'm going to talk about work in progress. The pension committee just met recently. I'll give you a little background. The projected benefit illustration standard was requested by the American Academy of Actuaries Pension Practice Council as part of their overall thrust of trying to reestablish the profession's credibility, given all the criticism over the cash-balance issues and actuaries scheming with plan sponsors to mislead plan participants. The proposal was



approved by the ASB in September 1999. The pension committee began drafting work in November, and it has been meeting monthly and having conference calls in between meetings. We are really working very hard. We sent a first exposure draft to the board in March 2000, and the board was not happy with the scope and restraint of trade issues, so they sent it back to the pension committee. We've been doing more work on it, and I expect it to go back to the board in June. Assuming the board approves exposure, you can probably find this on the Academy Web site in mid-July. You will probably get a little booklet with the August update.

I'll give you a little hint of some of the issues we're dealing with. We started out with a very broad scope of any kind of projected benefit illustrations, including your annual benefit statements. One of my long standing pet peeves was the statement that had a final pay integrated defined-benefit (DB) plan and a 401(k) plan with a relatively generous employer match. I used to get statements showing my defined-benefit plan, assuming no salary increases and my 401(k) showing 7.5% investment return. So I was going to get these wonderful replacement ratios out of my 401(k) plan. No wonder employees appreciate their 401(k) more than their defined-benefit plan.

The problem I always have is you're sort of mixing and matching. The DB line is probably not that bad because if you're trying to communicate what sort of income replacement they can get, it's a number that relates to what they're getting today. What do these 401(k) numbers mean? The 7.5% investment return has a pretty big inflation component built in, but there is no salary scale built in, so it's really not a very meaningful number. An alternative and what might seem a little more reasonable is building in salary increases and inflation but discounting everything back to current dollars. My DB results haven't changed too much; they've gone up a little bit because of the integration and the fact that it's the final pay plan. You ultimately get over the integration level towards the end. The 401(k) plan does not look nearly as generous here. I'm showing much lower income replacement. Why should I be putting 6% of my pay in this if I'm going to get 146% income replacement at 65. It's a totally phony number. So that was one of the types of things we were looking at.

Another thing we focused a lot on was the communication of cash-balance plans. I have a stack of samples that I went through.

If you're going to communicate effectively with your employees about retirement, you need to be able to build salary inflation in there. You don't have to show it in inflated future dollars.

In reviewing all the various cash-balance campaigns, there was one thing that I thought about again and again. In fact, in virtually every one of those cases, they used a salary scale. They used fairly consistent assumptions on interest credits. I couldn't fault the actuary or whomever prepared the projections for the assumptions and illustrations that they showed.

The thing that I would be bothered by would be the situation where a traditional defined-benefit (DB) plan was converted to a cash-balance plan on January 1,

1999. The starting balance had the present value of the December 31, 1998 accrued benefits computed at 7.5% interest and a 1983 Group Annuity Mortality table. The pay credit was 5% and the interest credit tied to T-bills just happened to be 5.5% for 1999. The plan provided a GATT lump sum on termination, regardless of how your benefit was calculated. It has to protect the accrued benefit. The statement would show that your pension grew 18% in 1999. You started out with a \$12,000 account balance. You had your 5% pay credit, and your account balance at the end of the year was \$14,160.

In this case, since I used the 7.5% discount rate to get the starting balance. The value of the frozen accrued benefit is significantly larger than the value of starting a cash-balance account. At the end of the year, even though you have a pay credit and your interest credit in the cash balance account is the lump-sum value of your frozen accrued benefit at the interest rate for 1999, it is still higher. The interest rate changed over the years so when we go up to January 1, 2000, my lump-sum value has actually gone down, This participant has accrued no additional benefit during the year. So it is misleading to be showing a statement that looks like that. One key issue is that the plan's sponsor must decide what it is communicating to its participants. Actuaries have no authority in this area.

Instead of going through all the alternatives, I'll just tell you where the committee is at the moment. At this time, we've abandoned an attempt to set a standard for the annual routine benefit statement. We're just addressing statements in connection with retirement plan amendments where the retirement plan amendment is defined fairly broadly. If you were terminating Plan A and implementing Plan B, that would be considered an amendment for this purpose. Furthermore, we did an innovative new thing for an actuarial standard, which is an actuarial opinion of compliance. The standard would only apply when the actuary is issuing an actuarial opinion of compliance. What does that mean? The actuary determines that the projected benefit illustration meets all of the requirements of the standards. The actuary can issue the actuarial opinion of compliance. If the illustration has obtained that opinion, the illustrations can contain language along the lines that a qualified actuary has determined that this illustration is prepared in accordance with generally accepted actuarial principles and practices. If it has not obtained an opinion of compliance, you cannot make that statement. It makes it a voluntary standard, and it applies only when the plan sponsor has decided to take this extra step of getting the opinion.

Why would the plan sponsor want to do that? Our hope is that this would become a mark of quality. We can somehow educate the public to be looking for this.

That's where things are at the moment. If you're doing something that is either not in conjunction with the plan amendment or is in conjunction with the plan amendment but the plan sponsor doesn't want this opinion, then you're simply guided by the Code of Conduct. As I pointed out earlier, the code requires that you not perform services that you believe are intended to mislead.

Watch for the exposure draft, review it and comment on it. I'm expecting we will get a fair number of comment letters on this exposure, and we can't improve it if

we don't hear from you. So I hope you will all review it and give us the benefit of your input.