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# Proposed pension standards would require individually reasonable assumptions

*by Heidi R. Dexter*

Actuaries may soon be required to select assumptions that are individually reasonable when measuring pension obligations. This is the core meaning of the proposed amendment to Actuarial Standard of Practice (ASOP) No. 4, as well as the proposed ASOP on the selection of economic assumptions. The current working draft is available on Actuaries Online.

Why have the Actuarial Standards Board (ASB) and Pension Committee emphasized individually reasonable assumptions? A strong case can be made that this improves the quality of the work and enhances user understanding. But there is another important reason—a few actuaries have deliberately selected assumptions that are not individually reasonable to avoid the intent of federal requirements. The lack of an explicit ASOP requirement that assumptions be individually reasonable has hampered efforts of the Actuarial Board for Counseling and Discipline to curb such practices.

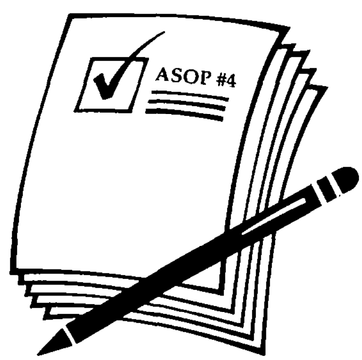
### Selecting assumptions

In drafting the proposed economic assumption standard, the ASB Pension Committee spent many hours grappling with how to limit abusive practices, while allowing plenty of room for professional judgement. Our solution is to require actuaries to select economic assumptions using an analytical approach that reflects their realistic expectations for the specific measurement. This does not imply that all actuarial peers would agree with the assumptions, but only that the actuary had a rationale that reflected reasoned, professional judgement.

Actuaries need to consider several factors when selecting economic assumptions, including recent and long-term historical economic data. Other measurement-specific factors to be considered are:

- Purpose of the measurement
- Characteristics of the plan and its participants
- The plan's investment policy and historical performance
- The plan sponsor's compensation practices
- Potential for volatility
- Expected plan termination.

Refined methodology and greater precision are not required in every situation, especially if they do not produce materially different results. The actuary must balance refined methodology, materiality, and cost-effectiveness.




Measurement-specific factors can vary considerably from one measurement to another. So, economic assumptions selected for one measurement may legitimately be very different from those selected for a different measurement. For example, economic assumptions selected to determine contributions to a large corporate pension plan with widely diversified investments probably will not resemble funding assumptions for a three-participant pension plan, invested exclusively in bank certificates of deposit, with 90% of the liability attributable to the principal owner who is only three years away from retirement, at which time the plan is expected to terminate.

### Working with mandated assumptions

Mandated assumptions sometimes present problems for actuaries who are attempting to select individually reasonable assumptions. When the law, a regulation, or another binding authority mandates an assumption, the actuary is obligated to use that assumption, even if it is not individually reasonable. This, by the way, is not a deviation from standard. Nonetheless, what disclosure standards should apply in this situation, and what effect should the mandate have on the actuary's selection of other assumptions?

The current working draft of the proposed economic assumption standard requires the actuary to reveal the source of the mandated assumption. It also permits the actuary to adjust other assumptions to maintain consistency with the mandated assumption, but only if appropriate, given the purpose of the measurement.

The recently exposed amendment to ASOP No. 4 proposes a different approach. It requires the actuary to disclose the source of the mandated assumption and its inconsistency with actuarial standards of practice. It requires the actuary to select other assumptions that are individually reasonable, without regard to consistency with the mandated assumption. The ASB and its Pension Committee are eager to see practitioners' comments on these alternative approaches to mandated assumptions. We will consider your comments when we complete the economic assumption standard and the amendment to ASOP No. 4.

### Other issues

By extending the individually reasonable requirement from economic to demographic and other assumptions, the proposed amendment to ASOP

No. 4 raises more questions:
- Are individually reasonable pre-retirement decrement assumptions feasible for small plans?
- Are simplified assumptions (for example, a single assumed retirement age rather than an age-related table of retirement rates) individually reasonable?
- Do we need to include assumptions for little-used ancillary benefits or other factors that are not truly significant to the measurement?
- At what point must we disclose a deviation from standard as a result of these issues?

The ASB and its Pension Committee are now finalizing the proposed economic assumption standard, continuing our work on ASOP No. 4, and beginning work on a standard covering demographic and other assumptions. Clearly, we need ideas on these issues from pension actuaries. Without your input and, ultimately, your buy-in, we cannot draft appropriate and effective standards of practice. We need these standards to help reestablish our profession's credibility and to shift the focus from what is legal to what is professionally appropriate.

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# Models of retirement income being researched

*by Judy Anderson*
*SOA Education Actuary*

The Society of Actuaries, the SOA Pension and Computer Science Sections, the Conference of Consulting Actuaries, and the American Society of Pension Actuaries are co-sponsoring research to evaluate macrodemographic and microsimulation models that could be used to analyze retirement and other public policy proposals. Researchers Joe Anderson, an economist, and Ed Hustead, an actuary, are now evaluating current data sources and models and considering the feasibility of developing such a model.

Economists and demographers built many of the existing models used for policy decisions at the federal level a number of years ago. A critical feature lacking in most models is a better understanding of plan sponsor behavior and private plan costs. This project is an opportunity for actuaries to work with economists, to learn more about their perspective, and to bring more of the actuarial perspective to policy analyses and proposals.

"This will be one of the most important research projects the actuarial profession has undertaken," said Chris Bone, chair of the Project Oversight Group (POG). Bone, eight other actuaries, and Olivia Mitchell, an economist and the executive director of the Pension Research Council, serve on the POG.

## SOA practice area VPs (continued from page 5)

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In the following months, practice areas will be featured in *The Actuary* with more specific issues and programs outlined for member feedback. Issues in the Health Systems practice area were featured in the February 1996 issue. (See "Profession-wide issues drive health leaders' activities" by Howard Bolnick.)