

September 27, 2013

Modeling  
Actuarial Standards Board  
1850 M Street NW, Third Floor  
Washington, DC 20036

Dear Sir or Madam:

This letter is the response of Towers Watson to the Exposure Draft of the Proposed Actuarial Standard of Practice (“ASOP”) Modeling. Towers Watson is a global human capital and financial management consulting firm specializing in employee benefits, human capital strategies, and technology solutions. Towers Watson employs approximately 14,000 associates on a worldwide basis, over 1,100 of whom are members of U.S. actuarial bodies subject to the standards. The undersigned have prepared our company’s response with input from others in the company.

Our comments generally support four central themes that we believe are critical for the profession and should be reflected in all Actuarial Standards of Practice.

- The ASOPs should be built upon the fundamental premise that an actuary needs to apply judgment based on the facts and circumstances of each particular situation. No written standard can anticipate every situation that actuaries will confront. In recognition of this fact, the standards should not be overly prescriptive and should not seek to substitute rules for the actuary’s reasonable professional judgment.
- The ASOPs should set forth basic professional standards, not best practices. The ASOPs have been and will be used against members of our profession in litigation. Incorporating best practices into the ASOPs will inevitably lead to characterization of those practices as minimum acceptable standards in litigation and client disputes. This places actuaries at unnecessary and significant risk. While we support the efforts of the actuarial profession to encourage the use of best practices, we do not believe that the ASOPs are the appropriate means to achieve that objective.
- The ASOPs should not impinge upon the terms of the engagement between an actuary and his or her Principal. Actuarial services subject to the standards are already highly regulated by governmental and other authoritative bodies. The terms of engagement are based upon a mutual understanding of those requirements by the actuary and the Principal. The ASOPs should not require the actuary to perform additional work that is outside the scope of the engagement, is not requested by the Principal, and for which the actuary is unlikely to be compensated. Doing so can also lead to the unintended consequence of Principals using non-actuaries, not subject to ASOPs, for activities that should be the province of actuaries.

- The ASOPs should not be written or interpreted in a manner that allows readers to presume that actuaries serve the “general public.” Our company’s actuaries are engaged to serve the company’s clients. While members of the public who are not our clients may benefit from our work, we nevertheless perform and deliver this work only for our client. No other person or entity can expect to rely on our work. We strongly believe that any ASOP that explicitly provides for or allows a presumption that actuaries perform work for the general public will expose actuaries to unwarranted and unmanageable risk.

We respect the effort and the quality of the considerations listed in this proposed ASOP. However, we believe that the guidance contained in the exposure draft could serve the profession better in a form other than an ASOP. We believe that the prevalence of what might be interpreted as models subject to the standard is so great that it will be deviated from regularly in practice. This is not intended to diminish its value, just to acknowledge that it does not represent basic standards, and the likely result of this published as an ASOP is to increase costs for our Principals and/or litigation risks for actuaries.

Our specific comments on the Exposure Draft are below, organized according to the questions listed on page vi. The primary focus of these comments is to limit the scope to address the issue noted above in the event that this does become an ASOP.

1. Does the proposed standard provide sufficient guidance to actuaries working with models?

Working with models is core to the role of being an actuary. Our exams, continuing education, and work experience are all vital in gaining the skills to competently provide our Principals with the modeling results needed as required by the US Qualification Standards. We believe that it is more appropriate to provide modeling guidance to actuaries through the existing structures rather than an ASOP.

As discussed further below regarding scope, the use of what might be viewed as a model is so ubiquitous that it would be exceedingly difficult for an ASOP to be relevant and effective in its application to all such situations. The exposure draft seems to recognize this in that it discusses situations where some of the guidance is not appropriate or practical. As such, the situation and professional judgment will very often result in the actuary deviating from the standard. We do not believe it is prudent to have an ASOP from which actuaries will deviate on a regular basis.

2. Is the proposed standard sufficiently flexible to allow for new developments?

The ASOP provides a checklist approach for considerations, actions, and disclosures to a broad set of situations, ranging from small scribbles on a napkin to massive computer models. Once one decides the ASOP applies, there is little flexibility. If one decides it does not apply, there is likely extra work required. What may have been a simple five minute calculation may now require a significant effort to document and defend why the ASOP was not followed.

3. The draft ASOP starts with a wide scope, but allows the actuary to use professional judgment to identify those instances (such as those involving minimal reliance by the user, or resulting in a non-material financial effect) where some guidance described in this ASOP is not appropriate or practical. Is this clear and appropriate?

Different actuaries will very certainly make a different decision on whether the ASOP applies, or does not apply, to similar situations. To protect oneself from litigation risk, there will be pressure to adopt the ASOP for situations for which it would be very reasonable to determine that it does not apply. As

a result, we believe that this proposed ASOP will either increase costs for our Principals or create additional litigation risk to actuaries.

Again, it does not behoove the profession to publish a standard with the expectation that there will be widespread deviation from the standard. The judgment of actuaries will often be called into question by others in situations where the standard is not fully applied. The result of this will be added process, cost and time to perform routine services.

4. In those instances where some guidance described in this ASOP is not appropriate or practical and the deviations from guidance are “not material,” the actuary does not need to disclose these deviations. Is this clear and appropriate?

The same comment as above applies regarding the tendency of this proposed standard to increase cost and litigation risk and the likely high frequency of these deviations.

5. Appropriate documentation simplifies later use and development of current models as well as allowing easier review by principals and other actuaries. Section 3 contains guidance with regard to documentation. Is this guidance clear and appropriate?

This section outlines appropriate project management concerns and documentation considerations in the development of models. We have concerns, again, about a checklist approach applied to the broad range of models requiring professional judgment for which many aspects will not apply to the broad set of models we perform. We believe that this comprehensive checklist is appropriate as an addition to training materials for exams, or continuing education, but we feel that this is not best served as an ASOP which should define basic standards, and not a list from which most will deviate in some regard, appropriately, due to the specifics of the model, project and circumstances. As an example of common deviations, the requirements of section 3 seem to be excessive for the use of routine spreadsheets that are used repeatedly on a daily basis by actuaries.

6. Does the use of bold font to identify defined terms improve the readability and clarity of the standard? If not, what suggestions do you have to improve the recognition of defined terms in the standard?

We found your approach to be a good solution to improve readability and clarity. All terms (even commonly-used terms) must be clearly defined up-front, and then used in a consistent manner throughout the ASOP. You have accomplished this.

If the Actuarial Standards Board (“ASB”) proceeds with the development of an ASOP, we have the following additional comments beyond those specifically requested.

### **Effective Date of the ASOP**

Section 1.4 of the Exposure Draft states that the effective date of the ASOP will be four months after adoption by the ASB. We view this as being potentially too short a time period and unclear. Modeling projects often take several months to complete. As worded, it is unclear from the Exposure Draft as to whether the ASOP will apply to work in progress. We suggest the Exposure Draft be modified to specify that it applies to projects commencing six months after adoption by the ASB.

## Clarifying the Actuary's Understanding of the Project's Objectives

Many sections of the Exposure Draft allow for judgment based on the financial importance of decisions based on the model results and the project's objectives. These include sections 1.2, 3.1.1, and 3.2. While we generally welcome guidance that recognizes and defers to the actuary's judgment, we are concerned that the Exposure Draft does not specify that such judgments are based on the actuary's understanding at that time. Some reliance on the Principal is needed for an actuary to make judgments regarding the potential importance of decisions based on the actuary's model. Circumstances may change for the Principal, without the actuary's knowledge, which may cause a seemingly insignificant financial decision to have much greater importance. We suggest that the Exposure Draft be modified so that it emphasizes the importance of the actuary's knowledge and understanding of the Principal's situation at the time that actuary is constructing, validating, documenting and analyzing the output of the model.

## Reconciliation

Section 3.4.2 of the Exposure Draft says that the actuary should consider including a reconciliation with a prior actuarial report, and that such a reconciliation should include an explanation of assumptions or methods that have changed from the prior realization. We have two concerns with this section of the Exposure Draft. First, there should be an emphasis on materiality; an actuary should not need to reconcile changes in assumptions or methods that are insignificant. Secondly, the section should acknowledge the added difficulty of performing a reconciliation when the prior model, realization or actuarial report was prepared by a different actuary.

Thank you for this opportunity to comment on the Exposure Draft. If you have any questions concerning our comments, please contact any of the undersigned directly.

Sincerely,



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