

## Because I Said So

I USED TO HEAR THE PHRASE “BECAUSE I SAID SO” when I was young. I am not sure why—maybe I was a rebel, or maybe I was just very inquisitive. I tried using the phrase with my niece and nephew when they were young, and although the phrase worked for a while, it didn’t work forever. And for good reason—“because I said so” does not provide any rationale or context.

An actuary knows the importance of providing such substantive information when asked “What?” or “Why?” because the importance of adequate documentation is stressed in the actuarial standards of practice (ASOPs). Although many ASOPs refer to documentation requirements, Section 3.2 of ASOP No. 41, *Actuarial Communications*, states:

In the actuarial report, the actuary should state the actuarial findings, and identify the methods, procedures, assumptions, and data used by the actuary with sufficient clarity that another actuary qualified in the same practice area could make an objective appraisal of the reasonableness of the actuary’s work as presented in the actuarial report.

Actuaries may have different interpretations of the meaning of Section 3.2, in particular the meaning of “sufficient clarity.” Therefore, many actuaries may have differing opinions of what constitutes appropriate documentation. Whether the intended user is a board of directors, an employer, an insurance company client, a regulator, etc., an actuary issuing an actuarial report should not presume that “the intended user understands what I did,” but instead should make sure the actuarial report satisfies the requirements of ASOP No. 41 and other relevant ASOPs.

Let’s review some specific examples of what might or might not be considered appropriate documentation. While the first two examples below relate to specific types of assumptions that

cross practice areas and are typically selected or recommended by the actuary, these are just examples—and the actuary should realize that appropriate documentation applies to all data, assumptions, and chosen methodologies. Appropriate documentation:

- States and demonstrates exactly what was done and why it was done;
- Provides the justification and rationale for each assumption; and
- Is such that another actuary can assess what was done and why it was done to make an objective appraisal of the reasonableness of the work.

### Example 1

The choice of mortality assumptions can be crucial across practice areas. Standard mortality tables are updated periodically. Common actuarial practice would indicate that the actuary should use the most current mortality tables and applicable adjustments or relevant experience data. Use of a different mortality table or judgmental adjustments should be clearly documented. Disclosures should satisfy the requirements of ASOP No. 41 and other ASOPs.

For life insurance statutory accounting, mortality assumptions have traditionally been prescribed by law, although actuarial judgment has become more important in the transition to principle-based reserving. ASOP No. 40, *Compliance with the NAIC Valuation of Life Insurance Policies Model Regulation with Respect to Deficiency Reserve Mortality*, provides guidance with respect to a specific situation in which the mortality assumption is prescribed by law, but allows actuarial judgment as well, subject to certain parameters. The model regulation requires use of the 1980 Commissioners’ Standard Ordinary (1980 CSO) mortality tables “as the minimum mortality standard for basic reserves.” The model regulation also includes several tables of



*I'll overnight the signed report,  
but the documentation may have to go bulk rate.*

select factors that may be applied to the 1980 CSO valuation tables during the first segment, as defined in the model, for both basic reserves and deficiency reserves. The use of “X factors” applied to the select factors is where the judgment comes in, and ASOP No. 41 provides guidance with respect to documentation and the testing and actuarial opinion required under the model regulation.

Many additional ASOPs, including but not necessarily limited to ASOPs Nos. 10, 24, 35, and 48, discuss mortality assumptions and the documentation and disclosure requirements. This documentation should include narrative and detailed quantitative support as to why the chosen mortality table was used, what adjustments were made and why those adjustments were made, and how those adjustments were determined in order for another actuary to assess the reasonableness of the work product.

### Example 2

Trend assumptions can be a significant component of many actuarial communications across all practice areas. Several ASOPs include discussions on trend assumptions and what an actuary should review, consider, and disclose. Support for any trend assumption should include a narrative explanation of the assumption and qualitative and quantitative details. Documentation should be specific regarding each aspect of trend:

- The source data and why it is appropriate;
- Any adjustments made to the source data and why the adjustments are deemed appropriate; and
- Any additional information that was considered and why the additional information is appropriate.

The narrative should explain and support the quantitative details. If there are multiple components to a trend assumption—for example, case mix, CPI,

cost, utilization, benefit plan change, and demographics—the narrative and quantitative details should be explicit for each component. The quantitative support should clearly demonstrate how, for each trend component, the assumption was derived and how it ties to the assumption ultimately used in the actuarial communication. It is not sufficient to state, “We made adjustments to the trend for X, Y, and Z” without demonstrating what the adjustments are, how they were derived, and why they were used.

Some trend estimates are publicly available, and some large consulting firms develop trend estimates based on their own internal data. When using a publicly available trend assumption or a trend assumption from a major consulting firm, an actuary must document why that particular trend rate is appropriate for the given circumstance (for example: Is the population new so that there is no credible historic data? Has there been a significant change in the demographics of the population such that historic information is not relevant? Does an outlook for major economic indicators suggest that the future will be very different from the past?). Regardless, an actuary should not use a trend assumption without a good understanding of what that trend represents and how it was developed.

### Example 3

Sometimes actuaries rely on other individuals for certain data and assumptions. It is not sufficient to state reliance on another individual for data, assumptions, or a methodology without performing tests for reasonableness and/or consistency unless such review is not necessary or practical as outlined, for example, in Section 3.17 of ASOP No. 4, *Measuring Pension Obligations and Determining Pension Plan Costs or Contributions*; Section 3.5 of the current version of ASOP

No. 23, *Data Quality*; and Sections 3.4.4 and 4.3 of ASOP No. 41. The tests for reasonableness should be clearly identified, documented, and demonstrated, including the conclusions reached as a result of the testing.

### Example 4

ASOPs or legislation may specifically state assumptions or methodologies that an actuary should use. Many ASOPs refer to prescribed assumptions or methods set by law. For example, Section 3.22 of ASOP No. 6, *Measuring Retiree Group Benefits Obligations and Determining Retiree Group Benefits Program Periodic Costs or Actuarially Determined Contributions*, indicates that an actuary should evaluate an assumption or method set by law to determine whether the assumption or method significantly conflicts with what the actuary believes is reasonable for the purpose of measurement. If the actuary believes it is unreasonable, this belief should be documented.

Section 3.7.7 of ASOP 6 also specifies the methodology that an actuary should use: An actuary should use age-specific costs in the development of the initial per capita costs and in the projection of future benefit plan costs unless the use of the pooled health plan’s premium may be appropriate without regard to adjustments for age. An actuary who decides to use premiums should specifically state and demonstrate why premiums are appropriate and should document the development of all adjustments used in the development of the premium rates.

In summary, actuaries need to state what they did and why they did it. It is that simple—because the ASOPs say so. □

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