AMERICAN ACADEMY of ACTUARIES

Regulatory Review Framework Recommendations
from the American Academy of Actuaries' SVL II Work Group

Presented to the National Association of Insurance Commissioners'
Life and Health Actuarial Task Force

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INTRODUCTION

As the NAIC reviews the appropriate use of a required regulatory review of actuarial opinions as a method for evaluating the validity of principle-based valuations of reserves or RBC, certain framing decisions will need to be made. The American Academy of Actuaries (Academy) recommends the following as a helpful consideration of the issues involved in deciding on the appropriate framework for a required review.

We will review six major items. They are:

I. Philosophy of Regulation or? Regulatory Objectives
II. Qualifications of Reviewers
III. Standards That Apply to Reviewers, How They Are Established, and Updated
IV. Required Frequency of Review
V. Independent Review Content & Distribution
VI. Regulatory Structure

Possible decisions on these items will vary depending on the scope of the required review. Specific near term requirements might include RBC and/or reserves for variable annuities with guaranteed minimum benefits and life valuation requirements. Longer term, the required review may be included in a modernized valuation law where the review focuses on the entire balance sheet or specified items within it.

I. Philosophy of Regulation or Regulatory Objectives

From the viewpoint of the Academy, we have seen an evolution in statutory financial standards and oversight over the last 25 years and this evolution continues with important decisions lying just ahead. An increasingly complex product environment has driven much of this evolution reflective of advances in the understanding and usage of more complex financial risk products built to finely tuned consumer and business needs. Our understanding of the traditional regulatory objective has been that reasonable policyholder expectations can be realized under moderately adverse conditions. This has been achieved through the following process:

- Define an objective standard for risk measurement
- Set a conservative standard to provide "peace of mind"
- Add an asset adequacy testing requirement so companies with experience that depends on more than just the liability side will maintain at least the established conservative standard
- Define an expected standard for capital designed to alert the regulator to companies with less than adequate capital before "it is too late"

This approach has the following consequences and challenges:

- Increasing diversity of products means it is harder for the regulator to compare results to a consistent conservative standard
- If standard is too high relative to a particular company's needs, then cost is either passed on to consumers, or fewer product choices (types) are available
- If standard is too high, results of required modeling may have little relevance to company management, so investment in the modeling process is minimized.
- If standard is too low, can the actuary be trusted to "do the right thing" to maintain conservatism for both liabilities and asset adequacy?
- If standard is applied to a broad class of risks, it does not give credit to company efforts to improve the risk selection process.
- In fact, this approach can encourage legalistic responses, so product design innovation includes or is based on how to take advantage of most beneficial reserve treatment
- Focus is on moderately adverse conditions. What is the appropriate way to address extremely adverse conditions ("tail events")?

The traditional view of a reserve is that it reflects a gradual buildup of a savings account that will be paid out in the future. Adjustments to the reserve may reflect that not quite all of the reserve amount will be paid out, or that some additional amounts are needed. Tail events (sometimes described as High Impact Low Frequency) describe conditions that may never require a payout or may require a payout that could never have been reasonably anticipated via the traditional reserve or capital accumulation process (for example, external events like a disastrous bird flu virus mutation that kills millions or a total collapse of the financial markets are not expected to be pre-funded in reserves). Rather, the more effective focus has been on early warning signals that show exposures like concentration risk or financial guarantee exposure, etc., so that steps can be taken early enough to ensure that a proper risk response can be taken. For example, the use of a Conditional Tail Expectation (CTE) measure in the C3 Phase 2 RBC requirements for variable annuities with guarantees provides an early warning indicator of possible exponentially increasing risk in the tail of a distribution of results. Thus, it as much about creating better governance as about defining a number that will be paid out in the future, especially when CTE measures are included in required sensitivity testing reviewed by a management held to a governance standard.

The traditional approach has been to hold reserves and capital with essentially two requirements; require holding admitted assets equal to reserves and capital, and require or permit regulatory intervention if those assets get too low. The use of a RBC formula allows for clear-cut legal backing when the regulator demands company action. It also creates tension between a formula that maintains "safety" for consumers and one that encourages a competitive and diverse market place.

More recent regulatory framework thinking, such as Basle II for banks and the Cornerstones concepts from the International Association of Insurance Supervisors (IAIS), have focused on the value of expanding requirements and incentives. Other regulatory regimes, such as the Financial Services Authority (FSA) in England, have also focused on this. The intent is to better assess a company's ability to manage risk in the future and to provide better early warning capability via some kind of modeling process, including the approved use of an internal capital requirements model.[1]

The NAIC has pursued the assessment process through its Risk Assessment Working Group. The focus there is not on the retrospective view obtained from an inforce balance sheet, but on operations, current and future. Through the CARRMEL process, it sets the prioritization for further reviews, in an effort to identify weaknesses before they became material. The incentive is that companies with good risk practices will get the regulators "out of their hair," allowing regulators to focus their resources on the company risks most in need of attention. It also requires the regulator and the company to have a meaningful discussion about the risks faced by the company. A poor score here could require the company to restate its financials, have the financial report suggest less than adequate management, shorten the time-frame to the next examination or even have the regulator assign the company an "In Financially Hazardous Condition" evaluation.

TO BE CONSIDERED:

- Would regulators be willing to pre-approve an internal capital requirement model that could produce higher or lower values than the RBC formula?
- Would regulators be willing to pre-approve an internal capital requirement model that could produce lower values than the RBC formula but with discretionary authority to effectuate changes in an insurer?
- Would the RBC technical formula floor need to be higher if it were a standalone oversight process?
- If the RBC technical formula floor is combined with other pillars or qualitative approaches, how would/could it be adjusted?
- Is a required Independent Review an adequate safety check on a number in the technical cash flow based calculation (through evaluation of the models and actuarial assumptions used) and/or is it an important input into a qualitative assessment process?
- As steps are made to commit to introducing more effective governance, while there will never be perfect governance, what will make for adequate governance?

II. Qualifications of Reviewing Actuary

Limited feedback from some regulators has indicated the following:

1) Current regulator concerns do not fault the current qualifications for asset adequacy certifications. The qualifications do clearly lay out the technical qualifications and they are being met (In the rare instance they may not, then the standards allow appropriate disciplinary action to be taken.)
2) Concern that sometimes there is seen a bit of sloppiness due to company not providing enough resources.
3) Current standards provide a range of practice that is sometimes too broad. Yet, it was also agreed that actuaries do redo modeling based on regulator suggested assumptions if there is "too much" divergence from that with which the regulator felt comfortable.

Are these views expressive of the experiences of a broader group of regulators?

[1] The one precursor to this in the 90's was that a qualified opinion increased the factor based C3 RBC charge. This was followed by the C3 Phase 1 evolution.)

Regulatory expectations for both professionals and non-professionals involved in a review of parts (or all) of the appointed actuary's work need to be documented. Key issues for the Life and Health Task Force (and other NAIC bodies) to consider in a reviewing actuary concept are:

A) Qualifications required
B) Appointment process
C) Required level of independence
D) Obligations to various audiences
E) Legal protections

A. Qualifications of Reviewing Actuary

The current qualification requirements for an Appointed Actuary are:

1. a member in good standing of the Academy;
2. meets the Qualification Standards for signing such statements;
3. familiar with the requirements;
4. has not been found by the commissioner to have committed inappropriate acts; or
5. failed to report such acts to the commissioner.

Professional standards, such as those described above, would ensure professional credentials as well as the applicability of Actuarial Standards of Practice and Continuing Education requirements. The Qualifications Committee is doing a redraft of the current qualification standards.

In addition, statutory requirements could specify additional requirements beyond professional qualifications. Possible additional requirements defined in the law might include the need to apply for a formal Practice Certificate to serve as a reviewing actuary. The granting of a Practice Certificate may be subject to satisfaction of professional standards as well as a demonstration of a minimum number of years of applicable experience and satisfaction of specific continuing education requirements.

What extra expectations are there when the opining and reviewing actuaries "rely" on someone not subject to qualification or professional standards? Is there a need to increase/require accountability through specific documentation procedure(s) when using reliance? What are the "professional" or legal obligations on information derived from an officer of the company?

B. Appointment of Reviewing Actuary

Under current statutory requirements in the U.S., a company's board of directors appoints Appointed Actuaries. In Canada, the reviewing actuary is chosen by the opining actuary and approved by a company's board of directors. The Canadian regulator may veto the selection of a reviewing actuary.

If there are different reviewing actuaries for different blocks of business, will there be a single, senior independent reviewing actuary? As these concepts are introduced, whether piece by piece or in aggregate, someone needs to "own" the verification that there is no double counting of assets or liabilities due to multiple specified model based reserves or capital as well as no missed assets or liabilities.

C. Independence of Reviewing Actuary

The role of the auditor in the process should be considered. The audit function may need to be redefined to consider the role of the reviewing actuary. This might require a change of focus of more aspects of the audit from a post-release to a pre-release review to include many key portions of the statutory reported values.

i) Should independence considerations limit the independent reviewer's consulting work (or that of a former employee) for the Company before and/or after performing the peer review?
   (1) Allowing other consulting work may give rise to real independence issues or at least the appearance of independence issues.
   (2) Not allowing other consulting work may result in an independent reviewer who is not familiar with the Company. This may result in additional time and cost for the review.
   (3) Some states have independence requirements for consultants when assisting with financial examinations. If the situation is considered similar, these requirements may be considered in setting a standard.

ii) Who appoints the independent reviewer?

(1) The Appointed Actuary, Company management, or the Board of Directors could choose the independent reviewer. Such independent review appointments (and subsequent changes to appointment) should have statutory notice requirements consistent with current Appointed Actuary notice requirements.
(2) The independent reviewer could be chosen by the state of domicile. This is the current practice for exams and in some cases for Cash Flow Testing reviews. However, those engagements have characteristics that are materially different from the independent review concept. Statutory exams have a significantly longer timeframe than a pre-release independent review (or post-release). Cash Flow Testing often does not result in additional reserves or capital (frequently by a wide margin such that small changes in assumptions have no effect on the ultimate opinion). Conversely, the items contemplated in an independent review will directly impact the balance sheet.
(3) For legal purposes, does the entity that retains the independent review actuary either incur some liability, provide some sort of indemnity (or protection from) litigation, or is it shielded under the requirements of the regulation based on good faith criteria as exist in Canada? The cost of such legal indemnity often can exceed the cost of services rendered.

iii) What should be the scope of the independent reviewer's activity?
(1) All actuarial items on the balance sheet could be included in scope as in Canada. This would be difficult to implement in the short term.
(2) Targeted items such as RBC – C3 Phase II, VA CARVM and UL / Actuarial Guideline XXVIII could be included in scope.
(3) The independent reviewer could be asked to concur on results. Current actuarial opinions are an aggregate test; a sufficiency in a block can offset an insufficiency in a totally different block of business. Can an independent review consider other items that are in excess of statutory minimums?
(4) The independent reviewer could be asked to concur only on assumptions and processes rather than results.
(5) Reasonable actuaries can (and often do) disagree as regard to future assumptions that are subject to significant judgment. Does the independent review have a safe-harbor window? For example, a "clean" independent review could be allowed if the independent reviewer's alternative assumptions or processes would fall within +/- N% of the reported values.
(6) What would a "qualified" independent review opinion be and what would be the implications? Is an independent review opinion qualified if the independent reviewer's alternative assumptions or processes would be materially different from the reported values? If so, what standards, if any, determine what "material" is?
(7) Can (will) the Appointed Actuary's opinion rely on the independent review actuary's opinion and or work?

iv) What changes need to be made to implement the independent reviewer concept and how long will it take to get this in-place?
(1) NAIC Model Regulation – SSAP, Appendix to SSAP, etc.
(2) Each state, Statute, Regulations, Bulletins, etc.
(3) Actuarial Guideline
(4) Professional Accounting Organization (AICPA)
(5) ASB – changes to ASOPs or new standards
(6) Academy Practice Notes, and educational material produced by the Society of Actuaries and others for independent review work, etc.

D. Obligation of Reviewing Actuary to Various Audiences

The process needs to consider the obligations of the reviewing actuary to various audiences including the opining actuary, the board of directors, policyholders, the regulators and the public. The role of the reviewing actuary in the process could be defined to include whistle-blowing and reporting requirements to the regulators to protect the public interest. The role and obligations will vary as decisions are made as to who "owns" the reviewing actuary work product.

E. Legal Protections of Reviewing Actuary

In Canada, opining actuaries are protected from lawsuits if the work is done competently and honestly. Such protection is not currently afforded to the reviewing actuary, although the reviewing actuary can attempt to negotiate indemnity coverage from the company as part of the engagement contract.

Further if the reviewing actuary is deemed to have whistle-blowing and reporting requirement to the regulators, consideration should be given to appropriate legal protections, such as relief from confidentiality requirements and protection against unfair treatment, including retaliation.

III. <u>Standards That Apply to Reviewers and How They are Established</u>

Standards of performance will be needed to support the concepts being proposed for US life valuation. In considering these standards, it is important to understand the different kinds of standards that can be used:

Regulations – In this context, regulations refers to laws, regulations, and Actuarial Guidelines or any binding authority. These "standards" have the force of law; therefore they must be followed.

Regulators (and legislators) must, of necessity, establish regulations. However, regulations can be, and often are, developed with the assistance of the American Academy of Actuaries. Sometimes, the Academy will make recommendations that it believes are necessary or appropriate to be included in the regulation. Under a principle-based regulatory environment, the recommendations will focus on the methods and techniques that an actuary will use to perform tasks that are the subject of the recommendation. In effect, the recommendations, if adopted as a law, regulation or actuarial guideline, will establish actuarial "standards." These "standards" should not be confused with Actuarial Standards of Practice adopted by the Actuarial Standards Boards.

Regulations may be based on currently accepted practice, leading edge practice or new practice. Regulations contain practices that regulators deem necessary to accomplish the valuation or perform other actuarial functions. Regulations also contain practices that the actuarial profession deems necessary but which the actuarial profession cannot mandate.

This process enables leading edge or new practice "standards" to be maintained and developed through recommendation from the Academy but adopted and implemented by the regulators. This process has been used in the development of the emerging regulatory requirements for reserves and capital for variable annuities with guarantees.

Actuarial Standards of Practice (ASOPs) – ASOPs are standards that must be followed unless any deviation from the standard and its rationale and effect are disclosed and the actuary is prepared to justify such deviation. ASOPs identify what an actuary should do in order to be considered to have appropriately completed an assignment. Thus, if the actuary believes that a portion of an ASOP is not appropriate, that actuary is free to do things another way, with appropriate disclosure, without the different way being considered a violation of the ASOP. However, the actuary may be called into question about the work even years later (e.g., during an examination), and may be called upon to defend the deviation to the Actuarial Board for Counseling and Discipline ("ABCD") if a complaint is lodged with the ABCD.

ASOPs are "intended to provide actuaries with a framework for performing professional assignments and to offer guidance on relevant issues, recommended practices, documentation, and disclosure."[2] They typically set the bar for performance at the level that is generally accepted practice for the profession. While the Actuarial Standards Board may, on occasion, determine that current practice should be elevated or changed to achieve an appropriate level, ASOPs generally represent consensus practice and are less likely to be based on new or leading edge practices that are not yet in common use. ASOPs will not normally impose standards on practice where a clear consensus of appropriate practice does not exist today.

ASOPs are useful in situations involving new practice areas although they are written to only consider current practice. In many cases, ASOPs already exist that are appropriate for the new practice. For example, a principles based valuation system will require an analysis of cash flows. An existing Standard, ASOP 7, *Analysis of Life, Health or Property/Casualty Insurer Cash Flows*, covers that.

The Actuarial Standards Board and the NAIC have historically been able to work together to develop a regulation that provides the requirement for certain work to be done and the foundation for how it is to be done while developing an ASOP that provides more detailed guidance to the actuary. The Life Insurance Illustrations Model Regulation is an example of such cooperation.

When a new ASOP is needed for a new topic, related ASOPs or related activity can be adapted or the new ASOP can be based on other activities. For example, a principles based valuation system may require an analysis of mortality results. While an ASOP has not yet been developed for this purpose, analyses of mortality results have been performed for decades so there is common practice that could form the basis for a new Standard, if one is deemed necessary.

[2] *Introduction to the Actuarial Standards of Practice*, December, 2004.

The Academy's Applicability Guidelines for Actuarial Standards of Practice notes that the following ASOPs apply to life actuaries performing cash flow testing to determine reserves. It is likely that most of these would also apply to principles based valuation.

ASOP	***Title***
No 1	*Nonguaranteed Charges or Benefits for Life Insurance Policies and Annuity Contracts*
No. 5	*Incurred Health and Disability Claims*
No. 7	*Analysis of Life, Health, or Property/Casualty Insurer Cash Flows*
No. 11	*The Treatment of Reinsurance Transactions in Life and Health Insurance Company Financial Statements*
No. 15	*Dividend Determination for Participating Individual Life Insurance Policies and Annuity Contracts*
No. 19	*Actuarial Appraisals*
No. 22	*Statements of Opinion Based on Asset Adequacy Analysis by Actuaries for Life and Health Insurers*
No. 23	*Data Quality*
No. 40	*Compliance with the NAIC Valuation of Life Insurance Policies Model Regulation with Respect to Deficiency Reserve Mortality*
No. 41	*Actuarial Communications*
No. 42	*Determining Health and Disability Liabilities Other Than Liabilities for Incurred Claims*

The Actuarial Standards Board (ASB), through its operating committees and procedures for exposure, develops, promulgates, adopts and publishes ASOPs.

Practice Notes – Practice notes are not "guidance" and actuaries have no obligation to follow them. They indicate what could be done, not what should be done, and require no disclosure regarding variance from the practices described. Practice notes are written by Academy members currently working in the particular area and are not intended to conflict with the ASOPs. In case of conflict, the ASOPs prevail. Practice notes cover a range of practices that some professionals follow but make no judgments about the appropriateness of those practices. Practice notes are not binding in any way.

Practice notes outline current practices that are found in the profession for a particular process. Practice notes frequently address new areas where there is no ASOP and may ultimately lead to an ASOP in the new area.

Practice notes are constructed by the Academy as an aid to practitioners. They help an actuary understand the many ways that something may be done without providing a Standard. They will not tell him or her which way to do it.

Regulator Issues – In considering standards governing the new system there are a few things the regulators will need to consider.

First and foremost, each time a requirement is desired by regulators, such as a requirement for establishing appropriate margins on mortality, the regulators should consider how best to make the requirement. The Academy and the Actuarial Standards Board (ASB) stand ready to assist the regulators as they make these determinations and in constructing the right form for the requirement, whether it be a method via a practice note, via an ASOP, or a requirement via some form of regulation.

Dispute Resolution/Updating of standards – Disputes will inevitably occur between opining and reviewing actuaries. There will need to be a dispute resolution process to address these disputes. This should also provide feedback to the ASB, to efficiently identify modifications or clarifications that need to be made in the standards. This would then help drive any needed updating of the standards.

Questions for Regulators:

There are two categories of questions that need to be addressed by regulators. First, there are general questions that provide overall guidance to the process of creating an appropriate regulatory structure for this purpose. Second are more specific questions that are related to the specific proposal for valuation. The first set of questions can be addressed currently. The second set will probably have to wait to be addressed after the specific valuation proposal has become more complete.

General Questions for Regulators:

1) What general guidelines could be used to determine those requirements that must be enforced through regulation?
2) What form for making changes, both initially and subsequently, is required (i.e. law or regulation)?
3) When can an ASOP be more appropriate than a regulation?
4) When can an ASOP be utilized to simplify a regulation or make it easier to change in the future?
5) What issues could be covered in practice notes rather than in regulations or ASOPs?
6) Should:
   a. Actuarial Standards be referenced in regulation:
      - In general?
      - Specifically?

   or

   b. It be assumed that actuaries would follow all ASOPs with no specific references to them?
7) The ASB is currently reviewing its status regarding independence. Is the current independence of the ASB sufficient? If not, what might be recommended?

Questions for Regulators Specific to the Proposal:

1) What aspects of the valuation need to be mandated? These must be addressed by regulation.
2) What aspects of the valuation should require guidance on the judgment of the actuary? These should be addressed by ASOPs. Is a new ASOP(s) necessary? If so, in what area(s)?
3) What aspects of the valuation would benefit from Practice Notes (which are non-binding)? Will new practice notes be needed? What are the areas in which practice notes are most likely to be needed?)

IV. <u>Required Frequency of Review</u>

A. While the company must file annual statements, it may be acceptable for the independent review to be less frequent. The process in Canada allows for the review to be every three years in most cases.

B. Frequency need not be calendar based, but could be event based. For example, if regulation leads to increased use of modeling, then business decisions (and product design changes) will be made based on the representation of inforce "reality", likely leading to new or modified assumptions about the future. Plus, decisions to hedge based on modeling will lead to new designs and increased need to review models. If considerable changes are made to a model or significant changes to the assumptions, these could be trigger events that require 'off-schedule' independent review.

C. To the extent that the results of the modeling option are not often reported by a company due to higher formula minimums or other constraints that prevent/preclude the effective use of the model, the company will have less/little incentive to evolve the model and less frequent review would be needed.

D. Relationship to CARRMEL methodology - Will the review also impact the CARRMEL assessment process?

E. An inter period, prerelease sign off could help limit (or more precisely focus) the scope of a triennial.

V. <u>Independent Review Content and Distribution</u>

Background Material

The Morris Review of the Actuarial Profession in the United Kingdom, after being made aware of ASOP 41 adopted in the U.S. in 2002, recommended the development of a "generic communication standard for all actuarial reports." The Report recommends the generic communication address the following items:

- Disclosure of assumptions used and a discussion of the extent to which professional judgment was exercised.
- Methodologies used and why
- Sensitivity analysis of outcomes
- Probabilistic analyses of key variables or indicators under particular scenarios
- Concerns the client should have bearing in mind the capacity to cope with various types and levels of risk.

ASOP 41 provides the "generic communication standard for all actuarial reports" that Morris recommends and it addresses at least the first three points in Morris' recommendation. Other communications and disclosures are required as appropriate to the circumstances.

ASOP 41's requirements for generic communications appear to be a reasonable approach to communication concerning the items subject to review by the independent reviewing actuary.

The description of the generic language can be translated into a "game plan" for the activity of an independent reviewing actuary. Since the form and nature of the independent review requirement has not been decided, the language below is subject to modification. Specifically, phrases such as "shall review" and "shall include" may have to be modified to fit the context of the requirement for an independent review.

- The independent reviewing actuary shall review all actions/decisions made by the actuary relevant to the actuarial work product subject to independent review (especially any changes from prior reporting approaches used).
- The independent review shall include a review of the data used by the actuary to make the decision or take actions relevant to the actuarial work product subject to independent review.
- The independent review shall include a review of the methods used by the actuary to make the decision or take actions relevant to the actuarial work product subject to independent review.
- The independent review shall include a review of the sensitivity testing performed by the actuary to evaluate the reasonableness of the outcomes of the decisions or actions taken by the actuary.
- The independent review shall include a review of the report prepared by the actuary for completeness and understandability.

Content Issues for Regulators

- Is the outline of the tasks for the independent review reasonable from the regulatory perspective?
- The outline of tasks deviates from the traditional generic communication standard in that the focus was expanded from assumptions to "actions and decisions". The concept of "actions and decisions" includes setting assumptions but also includes decisions such as the methodology for mapping funds to market proxies, the granularity of the inforce model used in cash flow model, the time step used in a cash flow model and decisions on items that need not be addressed directly due to immateriality. Do regulators agree with the expansion of focus from assumptions to decisions and actions?
- By linking the requirements for the actuarial memorandum/documentation applicable to the performing actuary with the outline of activities of the independent reviewing actuary, the process of the independent review can be made more efficient and, possibly, more effective. If the regulatory community finds the outline reasonable from the perspective of the independent reviewing actuary, do they feel that the same structure should be used for the actuarial memorandum produced by the actuary performing the actuarial task subject to independent review?
- If the regulatory community finds the outline described above unacceptable, what changes would they recommend?

Distribution – Background Material

The issues of who the independent review report is for (or more accurately what is the order of distribution) and how is it to be used will circumscribe the manner in which the independent review is done. For example, the Canadian system allows for a pre-release approach where the independent reviewing actuary works with the opining actuary prior to completion of the opinion on the most sensitive issues. The role is primarily to determine that the opinion is adequate, complete and comprehensive. It is not meant to 'second-guess' the opining actuary. As such, the order of distribution is:

- Opining actuary – pre-release approval of key assumptions and methodologies);
- Company management and Board of Directors – to respond to questions on report
- Supervisory officials – required function

In the UK, the Reviewing Actuary for life insurers reports directly and privately to the auditor.

Other options with initial reports to the Board or supervisors would have the appearance of more independence but could lead to more arguments and significant work to defend a position that would typically be settled between the two actuaries without the need for defending a stated position.

Distribution Issues for Regulators

- Is the approach used in Canada acceptable for the US with the reviewing actuary working with the opining actuary prior to release of the opinion and independent review report? If not, is pre-release discussion of key assumptions and methods to be used by the opining actuary appropriate?

- Is the distribution to the actuary and company prior to distribution to the regulators acceptable? If not, what concerns do regulators have (as this will better establish the acceptable role of the independent reviewer)?
- Are there aspects of the US state-oriented system that are not appropriately reflected in the Canadian approach outlined? If so, what are the most important of these?

VI. Regulatory Structure

What regulatory structure changes need to be made to allow a greater use of company specific models in light of the above discussion? Suggestions have included not only an independent review, but also increased required disclosure, both to regulators (likely a result of the independent review requirements), as well as to the public. The following items will need to be considered:

- Does validation of the valuation fall exclusively to the domestic regulator?
- Traditionally a primary role for regulators in the review of actuarial work has been to verify the numbers in the financial statements. Under the changes envisioned, is this still an adequate description of the necessary work? If not, what is the regulator's role?
- How are conflicts between the opining actuary and reviewing actuary resolved? Is there a role for the regulator in this? Must the regulator be informed of all or just significant conflicts?
- Under the changes envisioned, will the role of financial examiners and the financial examination process change? Are these consistent with the projected changes in the financial examination process (e.g. risk assessment approach) already underway? Does a redefinition of the purpose of a statutory audit need to be made?
- Is a goal of the actuarial review to "narrow the range of acceptable practice"? If so, how is this to be accomplished?
- How do regulators evaluate items such as corporate governance and the level of integration of models into company risk management in actuarial valuations and review?

Differences of opinion in acceptable ways to perform valuations have occurred between regulators in the existing system and are likely to be exacerbated under a principle based system without some system to encourage uniformity among states. Issues beyond the application of proper actuarial techniques, such as the quality of corporate governance and the level of integration of the valuation model into company risk management techniques, will assume greater importance. The level of staffing and expertise at the state insurance departments varies widely. Regulators need to have access to information on assumptions and practices by a large number of companies to assist in evaluating the reasonableness and adequacy of domestic company valuations and review.

These issues and others will strain the traditional regulatory structure and require a fresh look at the way regulators review and evaluate actuarial information. A principle-based system can only work if regulators are able to achieve reasonable consistency in the understanding and evaluation of the actuarial work.

Questions for Regulators:

1) Who has the regulatory role? What are the implications (e.g., state based system, resources, consistency, and effectiveness)?
   - Domestic state
   - Lead state for the group of companies
   - State with "accreditation"
   - Interstate compact policies
   - National repository
   - Any state in which the company is licensed

2) What are the role, responsibility and goals for regulators in the new world? How does one balance the following conflicting goals:
   - Solvency
   - Individual risk recognition
   - Early warning
   - Consistency
   - Transparency
   - Prescribe principles?
   - Narrow the range of practices?
   - Align with company's risk management?

- Build controls, governance?
- Audit results?
- Enforcement

3) How to do it?
   - Governance? How to build governance so that company management can be the first defense and what regulatory consequences should be built?
   - Independent review? What should be subject to independent review? What does an independent review mean?
   - Auditing? What does auditing mean in the new world?
   - Disclosures?
   - Prescribe principles?
   - Provide guidance?
   - Will there be differences between reserves and capital requirements?
   - Will there be different requirements based on company size or products?

4) Who will do them? What type of communication needs to be built?
   - To what extent can regulators do it? What additional training and resources are needed?
   - To what extent can regulators rely on others (professional standards, reviewing actuary etc.)?
   - What are the roles and responsibilities of each party?
   - What type of communications or reporting relationship should be built?
   - What type of reports should be submitted?

5) What work needs to be done to get there? What will be the role of:
   - Regulators
   - NAIC Committees (LHATF, CADTF, SAPWG, etc.)
   - Actuarial profession through the Academy
   - Actuarial Standards of Practice through the ASB
   - Industry
   - Other users of the statutory information (e.g., rating agencies)