

# Required Review of Principle Based Valuation Opinions

LHATF SVL II Update

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# .....Outline of Today's Discussion.....

- How Much “Peace of Mind” Can be Given Concerning Company Solvency?
  - ❖ Formula Approach vs. Principle Based Approach
- Review Canada's Approach
- Who Needs to be Involved in the US?
- Review Needed Regulatory Involvement and Decisions
- Next Steps

# Formula Approach

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- Define an average standard for risk measurement
- Can set a conservative standard to provide “peace of mind”
- Can then add an asset adequacy testing requirement so companies with experience worse than the average conservative standard can be highlighted

# Formula Challenges

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- Increasing diversity of products means harder to find a consistent conservative standard
- If average is too high, then cost is either passed on to consumers, or less choice is available
- Plus, modeled results may have little relevance to company management, so investment is minimized in the modeling process
- Some are claiming that the actuary cannot be trusted to do the right thing for asset adequacy

# Principle Based Approach

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- Use a modeling approach based on company experience, when appropriate
- For example, Canada generally uses one final set of company specific deterministic assumptions with extensive experience analysis and sensitivity/asset adequacy testing as the underpinnings for the final set of assumptions
- Canada also requires a complete stochastic testing for seg fund guarantees, essentially a time value of equity guarantees with lapse and expense risk

# Principle Based Challenges

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- Biggest concern has been oversight. Is there too wide a diversity of practice due to internal company pressure or self interest?
- Defining appropriate governance. For example, solutions of a Required Independent Review or mandated linking of pricing and valuation assumptions will require new regulations.

## Summary of Canadian Required Regulatory Review

- Everything in the company's balance sheet is open to choice by the actuary
- Required Peer Review was adopted to narrow the range of practice seen/observed
- Reviewing actuary and opining actuary must agree on all assumptions used in order to provide a clean review. (If needed, there is a governance procedure to address unresolved differences.)
- So far, the peer review process seems to be doing this effectively.

# Key Elements of Canada Requirements

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- Reviewer is picked by the appointed actuary, approved by the company's board with veto power on selection by the regulator.
- Qualifications for reviewer are the same as those needed to be the appointed actuary.
- Review is usually done on a pre-release basis.
- Legal Protection currently to appointed actuary only, who is shielded from lawsuits if work is done competently and honestly. Reviewer does negotiate indemnity coverage (if desired) as part of engagement process
- Canada has had two years of experience with this process



# What Key Groups Need to be Involved?

- Same as Needed for the Illustration Actuary Regulation
  - ❖ Actuarial Standards Board (ASB)
  - ❖ Academy (AAA)
  - ❖ Regulators
- ASB will be meeting later in March
- AAA SVL II Committee - Organize conceptual framework and options
- All three need to concur on process for dispute resolution and future balance of governance process

# Regulators Are The Customer

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- The recommendation should provide enough “security”/comfort around modeling based approaches that both the regulators and industry can enjoy the benefits of more economic (reality) based reserves and capital.

# Regulators Are The Customer

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- List of possible tools include:
  - ❖ An Appointed Actuary with Professional Standards
  - ❖ An Exec or Analytic Summary
  - ❖ Collect key valuation assumptions in a centralized manner for regulators
  - ❖ Required Integration of Pricing and Valuation Assumptions
  - ❖ Required Independent Review
  - ❖ Ability to shape/influence future modifications to Oversight Process as feedback emerges

# Align Process So All Appropriately Incented

- Define feedback loop/governance process to “self correct” or fine-tune the process over time
- Timing of review – pre or post release of company numbers
- Coordination with the audit function to clarify accountability and reliances

# Major Regulatory Considerations/Steps

- How to Require a Review - Law vs. Regulation
- Legal Protections, Obligations, Confidentiality & Qualifications
- Desired Scope, Frequency, Content of Report
- Coordinate NAIC Risk Oversight Process/Governance

# AAA Next Steps

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- Coordinate ASB, AAA, NAIC dialogue
- Review & Summarize Soon To be Released Morris Report
- Continue Communication with SOA and IAA
- Lay out Options for June - But need Regulatory Involvement/Dialogue