SOCIETY OF ACTUARIES Management & Personal Development Section

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The Actuarial Ethicist: Stochastic Cherry Orchard

by Frank Grossman

This short article sets out a hypothetical workplace dilemma. We invite SOA members to submit comments and suggested solutions which will be summarized and published in the following issue of The Stepping Stone. *All member submissions will be received in confidence, and any identifying details removed prior to their inclusion in the discussion of the case.*

Lennie the FSA has been asked by his manager, Anita the FSA, to revisit prior analysis of the investment guarantees embedded in their large inforce block of universal life policies. This work was last undertaken five years ago, and though the findings were not summarized in a memorandum or report, they indicated that the cost of the minimum crediting rates was modest. Prevailing fixed income yields have declined significantly since then, prompting the divisional risk management committee to ask for an update during their next meeting in three weeks. Anita is a member of the committee, and reminded Lennie that the pre-read document distribution deadline is one week prior to the meeting—so, he has only two weeks to complete his assignment.

As the generation of economic scenarios is the responsibility of their firm's investments division, Lennie promptly received 6,000 scenarios assembled by Mike the quantitative analyst. Given the heterogeneity of the UL block, including its many minimum crediting rates and other product feature variants, Lennie plans to run one set of stochastic seriatim asset-liability projections with the inforce model's minimum crediting rate logic invoked, and a second set without. Anita agreed with this approach, but due to the looming deadline suggested that Lennie first stratify the scenarios, based on their estimated asset portfolio total returns over 20 years, and then run only the scenarios associated with the lowest (or worst) 500 total returns.

Mindful of the dynamic policyholder behavior assumptions within his model, Lennie sugested that "negative cherry picking" scenarios (so to speak) using a 20-year total return statistic might not be the best idea. Anita disagreed, stating that, "that's how the work was done last time." Lennie asked who performed analysis five years ago, and Anita responded, "I did."

What should Lennie do?

Send your suggestions before July 22, 2010, to Craigmore54@aol.com. The discussion of Lennie's dilemma will be published in the October 2010 issue of The Stepping Stone.