Article from:

# Actuary of the Future

November 2009 – Issue 27

# An Actuarial Tour of the New Economic Landscape

*By Jennie McGinnis*

*NOTE: The views expressed are those of the interviewees and not necessarily those of their employers.*

The economic landscape has changed drastically over the past year. With a number of government initiatives being passed and others on the horizon, actuaries are sure to consider how these changes affect them. The Actuary of the Future Section sponsored a session at this year's Annual Meeting that sought to assist actuaries in identifying the different features of the actuarial world as we know it today. Entitled "An Actuarial Tour of the New Economic Landscape," presenters set out to describe:

- The lush forests: The areas in which actuaries will continue to thrive, and perhaps gain even more productivity, as a result of government action.
- The sandy beaches: While the sand may be hot (that is, there's a possibility that actuaries will come under pressure), operating in these areas will generally be like a day at the beach.
- The barren desert: Hot, dry and dreadful — be on the lookout for these areas of increased intensity and scrutiny.

During their preparation for the session, the panelists shared their thoughts on examples of each and their views on possible changes going forward.

## LUSH FORESTS

Despite the often-negative media attention concerning the economic environment, the presenters found plenty of examples of lush forests that exist today. There is clearly an "opportunity to advance the actuary as expert in managing the risk of financial promises," according to Dave Sandberg, vice president and corporate actuary at Allianz Life Insurance Company of North America.

Referring specifically to the life insurance industry, Fred Andersen, supervising actuary – life, for the New York State Insurance Department, noted that the "industry has fared well relative to other financial services industries.

*Jennie McGinnis is assistant vice president of risk management at Swiss Re Life & Health America Inc. She can be reached at Jennifer_McGinnis@swissre.com.*

CONTINUED ON **PAGE 26**

In addition, Sandberg stressed the possibility that years of actuarial practice, approaches and skills may bloom into new applications beyond insurance. "Actuaries have spent many years designing and working with models built around the interactive agency effects of policyholders and company management. This may be very useful [when applied] to the systemic issues that impact the larger economy."

## SANDY BEACHES

Certainly, the industry has not gone unscathed. "Life insurers and their actuaries will be subject to additional disclosure," suggested Andersen. "There will also be more parties within a company providing oversight on the evaluation of nontraditional risks." Sandberg agreed, noting that "expanding ERM (enterprise risk management) to a more comprehensive and proactive view of addressing future risks" will be necessary, but comes with its own difficulties.

There is also the hurdle of raising capital and communicating the need of doing so with stakeholders. Educating "policyholders and agents that scarce capital affects new sales, but is not about the company going under," will be an important challenge to address, shared Sandberg.

There is opportunity for actuaries to be given credit for their piece in maintaining industry solvency, possibly bringing more attention to their services."

The pension arena has its own forests as well. David Driscoll, principal and consulting actuary at Buck Consultants, recognized "governmental pension plans, pension compliance issues (particularly those arising under the Pension Protection Act) requiring actuarial skills, and nonqualified plans" as areas of continued productivity for actuaries.

Companies that made wise decisions regarding risks and sought to ensure their understanding of those risks have found themselves in a situation of being able to better and more easily manage their capital positions, commented Sandberg. The market is also expected to recognize those "companies that can simply explain the risk and rewards of their products."

A CLEAR MISTAKE WOULD BE TO "HOPE THAT WE CAN ALL JUST GO BACK TO HOW IT USED TO BE"

## BARREN DESERT

One well-known example of an area that has come under increased intensity and scrutiny relates to the pension field. Driscoll noted that qualified, private-sector defined benefit plans have faced a difficult struggle as their sponsors cope with a regulatory framework that was extensively changed by the Pension Protection Act and funding problems arising from last year's market meltdown.

Other characteristics of the barren desert relate to how the industry proceeds going forward. A clear mistake would be to "hope that we can all just go back to how it used to be," shared Sandberg. Solutions must be created wisely, though. The "possibility that solutions applied to clean up the broken areas of the financial services arena will be applied to insurance in a blanket fashion [will] increase systemic risk and the cost to society, as well as prevent new product opportunities."

Andersen pointed out that there are also concerns relating to principle-based reserving, as more constraints are expected as a result of the current environment. "Scrutiny will come in the form of additional interactions with regulators."

## OUTLOOK

Recognizing that the economic environment can change quickly, what can be expected in the next few years? On the pension front, Driscoll expects very little change in the need for the services of pension actuaries. In the longer term, however, he anticipates that the number of offerings of qualified, private-sector defined benefit plans will continue to shrink.

As firms begin reserving using a principle-based approach, "the amount of disclosures and justification required to be submitted by company actuaries will rise exponentially," warned Andersen. "Actuaries will be under more pressure by their management and by regulators to account for [the volatility of interest rates, equity markets and the overall economy] in their projections."

Sandberg sees two possibilities moving forward. "We choose solutions that are familiar or we use first principles to solve and prevent the real problems." In the case of the former, expect "increased conflict and confusion over regulatory jurisdictions [and] vastly increased noise due to many kinds of reporting that cannot be understood across regions and industry segments." Long-term, this could likely result in yet another systemic failure.

If the latter option emerges, the industry would find that "risk is not buried or lost. Companies [will be] accountable for measuring and managing their risks as clearly as debits and credits track the flow of cash." This will require a steep learning curve, but will also provide an opportunity for actuaries to develop the tools needed to meet these goals. In the long run, it is expected that this direction would "vastly reduce costs of regulation, yet [provide] far [greater] ability for people to choose the risk they want to take." Also, this scenario provides "greater security [for] policyholders and the public …as well [as] the safety of the broader financial system."

The shape of the future economic landscape will be impacted by the role actuaries play in the resolution of the current recession. By doing our part we can ensure that risk is not seen as bad, dangerous or frightening, but as opportunity. ☆