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The Zen Actuary Installment 3: "Don't Just Check the Box"

By Rich Lauria

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Author's Note: *This is the continuation of a series*[1] *adapted from the book Awake at Work by Michael Carroll, covering the application of Buddhist teachings to situations encountered in a modern corporate workplace setting. This series addresses challenges frequently encountered by practicing actuaries.*

The responsibilities of many practicing actuaries include compliance duties. Examples abound throughout the various practice areas:

- Many pension actuaries are heavily involved in work that complies with the Employee Retirement Security Income Act (ERISA) and various sections of the Internal Revenue Code.
- Financial reporting actuaries working at insurance companies are involved in setting reserves for U.S. GAAP and/or statutory purposes. This work must comply with Sarbanes-Oxley 404, Model Audit Rule, and Actuarial Opinion and Memorandum Regulations.
- Pricing and product development actuaries have their own rules to follow. Life actuaries producing policyholder illustrations must comply with Illustration Actuary regulations, while non-life actuaries filing rates must comply with various state regulations on rate filings.
- Even risk management actuaries at U.S. insurance companies will have regulatory compliance in the very near future with requirements regarding Form F and Own Risk and Solvency Assessment (ORSA) regulations.
- Actuaries working outside of the United States have their own compliance regimes to consider.

In addition to legal requirements, the actuarial profession itself has its own set of do's and don'ts through the Code of Conduct and Actuarial Standards of Practice (ASOPs). These standards help guide the practicing actuary through myriad professional and ethical situations. And in a post-Enron, post-Madoff, and post-housing bubble world, most organizations that actuaries serve have their own code of ethics that must be considered.

The purpose and intention of all of these rules and guidelines are admirable. They provide actuaries with guardrails and guideposts to practice their craft. They serve as a foundation for the quality, integrity and usefulness that the actuarial profession aspires to for all of its members to maintain in their work. A lack of such literature would likely produce less comparable work product across the profession, with members applying their own standards of practice to the task at hand.

However, it is important to note that such rules support rather than replace good actuarial practice. They enhance the actuary's natural ability and intention to produce valuable analysis that helps the client or employer make better decisions under uncertainty. These innately high standards and aspirations that an actuary brings to his or her vocation can be referred to as the "li" of the actuary. Per Michael Carroll in *Awake at Work*, the term "li" derives from ancient Chinese artists who carved jade into figures and decorative designs, working with the stone's tendency to crack along its natural contours. These lines were referred to as the "li" of the stone, and the sculptor's challenge was to bring out this natural beauty. Similarly, the various regulations, codes of conduct and professional guidance help bring out the natural goodness of actuarial practice, beyond just "checking the box."

All of these rules and regulations can produce a false sense of security. Simply following them in a mechanical fashion does not guarantee high-quality output. Such blind compliance only provides a legalistic defense of one's analysis. It is not enough to simply calculate statutory minimum reserves and post them to a ledger. The actuary needs to have a view on whether they are sufficient under various scenarios and using acceptable criteria of reserve adequacy. And if they prove to be redundant, the actuary should be able to tell management the level of excess and trends in that amount.

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The ASOPs are not prescriptive by design. They provide the actuary with a litany of items to consider in choosing or designing an actuarial methodology, setting assumptions, and interpreting and presenting results to the audience. The actuary must do the hard work of making these decisions and understanding the consequences and trade-offs of each one. The actuary must assess the strengths and weaknesses inherent in the modeling, and the level of confidence in relying on the output. In short, the actuary must tap into his "li" of natural ability and intellectual curiosity, strengthened by extensive training and the educational demands of the professional curriculum, and further cultivated by an inner desire to generate one's best effort. The ASOPs nurture but do not guarantee such performance.

Following the rules is a necessary but not sufficient condition for professional success. No rulebook can ever anticipate every possible situation that an actuary will face in one's career, just as no model can successfully predict every possible scenario. As with other aspects of life, actuarial practice has its share of gray areas where there is not necessarily a right or wrong approach. In such cases the actuary will need to take a step back and evaluate several viable options to solving the problem at hand.

In dealing with such challenges, the actuary should use the regulations and standards of practice as a reference point for simpler cases of a comparable nature, and consider the goal of the exercise when making a final decision. For example, when setting statutory reserves for a new product with no prescribed standards, the actuary should look to existing standards for comparable products as a starting point, adjusted for product feature and data availability differences. Multiple methods and sensitivity testing should be performed before reaching a final conclusion. And experience should be monitored closely, especially if production accelerates.

Many of the newer regulations affecting actuarial practice are intentionally less prescriptive. Principle-based reserves (PBR) and ORSA lean heavily on actuarial judgment, cultivating rather than dictating actuarial "li." This puts increased emphasis on professionalism and encourages actuaries to put their best foot forward in serving their clients and the public at large. In addition, this trend toward more flexible regulation provides actuaries more leeway to find the natural contours in performing their analyses that fit the products and business models that their clients and organizations are executing. This results in many acceptable approaches, going beyond a one-size-fits-all mentality. It also gives actuaries the opportunity to develop an analytical framework that serves multiple purposes: satisfying regulatory requirements, informing critical risk and solvency insights, and providing trends in key profitability drivers to guide strategic decisions.

This brings more relevance to compliance efforts and fosters increased efficiency in the actuarial function. Senior management and boards of directors will view actuarial compliance efforts as more than simply avoiding fines and regulatory quagmires. Actuarial management becomes more integrated with all parts of the organization, removing silos and coordinating activity with other critical areas.

Actuaries play a vital role in the financial risk management of many organizations. Some of these companies are considered systemically important to the financial markets. The profession is historically well-respected and trusted, and its public profile is expanding by the day. We are seen as risk management leaders, and our services are increasingly being sought out. By being much more than minimally compliant, actuaries can further seize the day and offer cutting-edge services to their clients and organizations. Providing such value should ultimately result in a more stable and reliable financial system, and a more trusting public that is increasingly willing to place its hard-earned savings in the products and services we design. Moving beyond a "check the box" mentality and cultivating the "li" inherent in each of us offers us the opportunity to make this vision a reality.

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ENDNOTE

[1] The first two installments in the "Zen Actuary" series, "Balancing the Two Efforts" and "Be Authentic," were published in the November 2013 and February 2014 issues of *The Stepping Stone*, available online at *www.soa.org/mpd.*