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SOA Assumption Development and Governance Discussion
THIRD QUARTER 2013 CALLS

By Drew Besendorf

Drew Besendorf, FSA, MAAA, is managing actuary at Humana. He can be reached at dbesendorf@humana.com.

Having assumption committees for governance and oversight is gaining wider acceptance amongst U.S. and Canadian companies. Given its newness in most companies, the structure of these committees, the assumptions reviewed, and the buy-in from departments vary by company. The Assumption Development and Governance Group (sponsored by the Financial Reporting and Product Development sections), formed in 2013, discussed these topics in detail during its September meetings. This article consolidates the practices mentioned by various companies during the discussions.

STRUCTURE OF THE ASSUMPTION APPROVING COMMITTEES

Typical members of the approving committee include, but are not limited to, the CFO, chief risk officer (CRO) and chief actuary, with some committees also including the appointed actuary, pricing actuaries, valuation actuaries, illustration actuaries and accountants/controllers. Meetings may occur quarterly or annually, with extra meetings as necessary. Approving committees start the year with a meeting to discuss which assumptions to review for the upcoming calendar year. An assumptions list is created and disseminated amongst all interested parties. Working groups are assigned to address each assumption. The working groups meet more frequently during the year and provide the approving committee with a formal update quarterly on their progress. Typically, one or more members of the approving committee is involved in the working groups. Experience studies are conducted and peer reviewed, and impact and sensitivity testing is done to identify material changes and to find modeling errors. Margins are discussed.

The most important meeting of the approving committees occurs annually; it is usually in the third quarter to accommodate deferred acquisition cost (DAC) unlocking and year-end reporting. The work groups present their findings, including the lists of the assumptions, supporting evidence of the assumptions, and supporting evidence of correct implementation; material risks and outstanding issues are discussed. Use of a formal voting process varies amongst the companies. Some companies try to gain consensus while others specify members who get to vote.

ASSUMPTIONS REVIEWED

Liability and economic assumptions are formally reviewed. Extra scrutiny is put on the most material assumptions and on those assumptions not stipulated in the exercise (e.g., short-term versus long-term outlook on interest rates and asset spreads). Thresholds are set to clarify if an assumption needs to be updated. In setting the thresholds, companies use confidence intervals, A/E ratios, or credibility relating to impacts on profitability, capital, reserves or policyholders. The goal is a consistent, measurable approach. Most companies are enhancing their guidelines in preparation for upcoming principle-based reserves (PBR) and Own Risk and Solvency Assessment (ORSA) requirements.

Various methods of storing the assumptions and minutes of the assumption meetings were discussed, including SharePoint, databases, spreadsheets and stored memos. The documented assumptions are put into standardized templates and are typically dozens of pages in length. Peer review is formally documented. "Challenges" to the assumptions are captured to show the peer review was detailed enough.
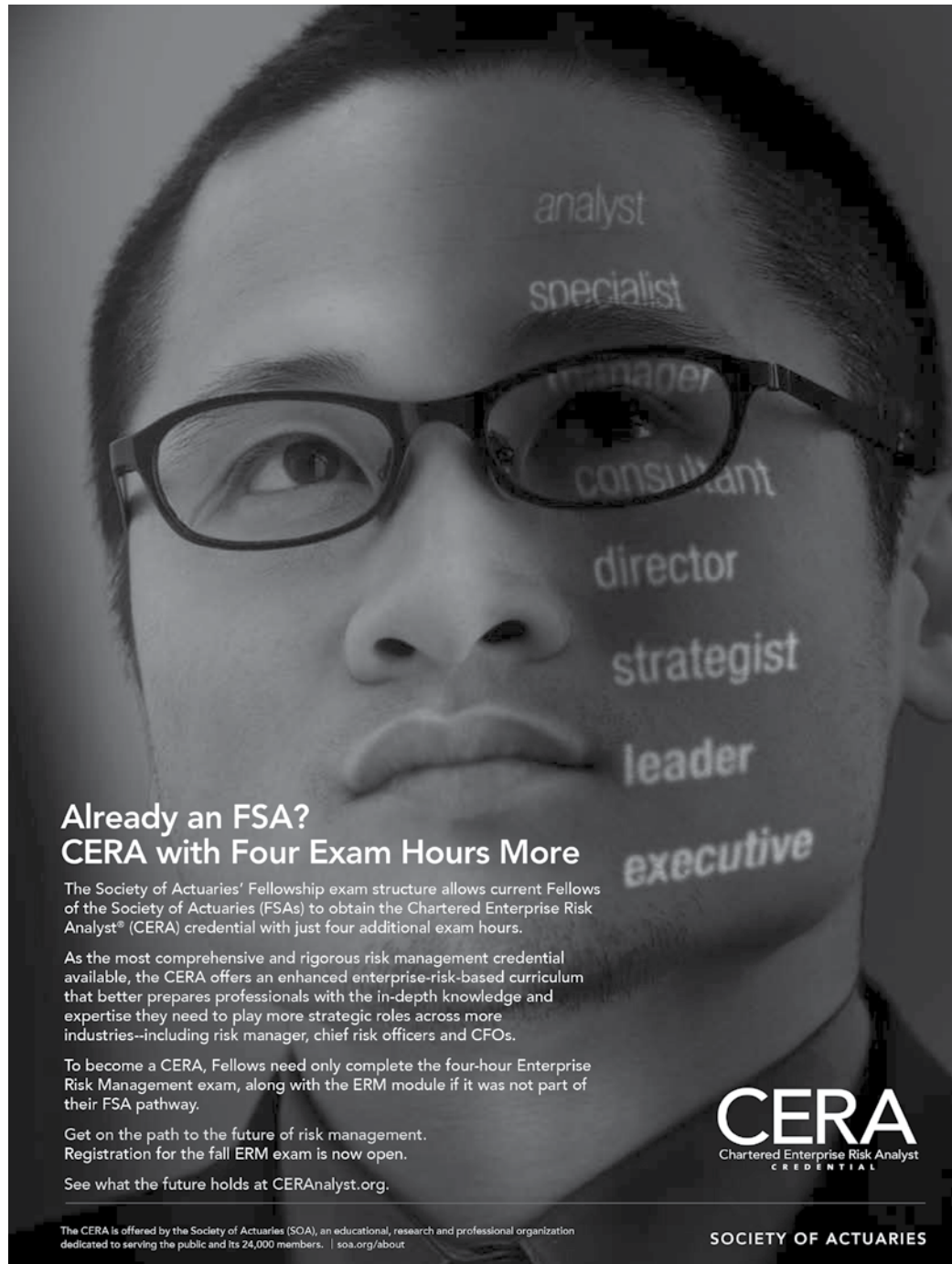
BUY-IN/COMPLIANCE AND CONSISTENCY

Given the demands of the assumptions work, more representation from the data users on the committees/ work groups eliminates a lot of the problems with provider push-back. Standardized templates helped improve the initial responses from the documentation providers and greatly decreased the work required from future responses. Push-back is most typical from parties needing immediate responses to keep up with work demands because the review process can delay implementation.

Companies strive to make their assumptions consistent across pricing, valuation, reserve adequacy testing, and illustrations. Most start with the same assumption across all applications, but it's difficult to retain consistency. Consistency doesn't always mean "the same" as there can be short-term and long-term views of assumptions or reasons to vary, such as a new product feature. Mortality improvement was brought up several times during this discussion.

The benefits of these committees are many: improved communication, documentation, consistency, accuracy, auditability and control. With the increased emphasis on assumption governance coming from risk-focused audits, actuaries should welcome the presence of these committees as an important part of their companies' risk mitigation strategy.

FUTURE ASSUMPTION DEVELOPMENT AND GOVERNANCE DISCUSSION GROUP CALLS

If you are interested in joining our conversations, please contact me at dbesendorf@humana.com or 502.580.2262. Also, look for announcements regarding future calls in the SOA updates and on LinkedIn under "SOA Assumption Development." ■