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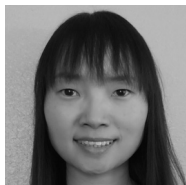
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A Refreshed Look at Assumption Governance

SOA Assumption Development and Governance Discussion—1Q15 Calls

By Michael Chan and Min Xu

Michael Chan, FSA, is a manager at PwC. He can be reached at michael.ky.chan@us.pwc.com.

Min Xu, FSA, MAAA, is an assistant vice president at Pacific Life. She can be reached at min.xu@pacificlife.com.

With increased scrutiny on assumptions, companies are ramping up efforts and resources to increase governance around assumptions. This is the third year since the formation of the Assumption Development and Governance Group (the Group).[1] It offers a forum for actuaries to discuss current topics and establish industry contacts. This year the Group established formalized contacts with the SOA Product Development, Financial Reporting, Modeling, and Technology sections to better coordinate assumption related activities.

The 2015 first quarter discussions took place on two conference calls on March 2 and 3. Representatives from approximately 30 companies were in attendance, and additional participants from these companies listened in. Topics of discussion included 2014 accomplishments and "a-ha" moments, 2015 focus, as well as questions for the group. Several common themes emerged. The most frequently discussed topics include governance structure, documentation requirements, and increasingly, the role of data and advanced analytics in assumptions development. The most common drivers cited for interest/activity in this area include:

- Increased regulatory demands, from both state regulators and federal authorities;

- Anticipation of Principle Based Reserves (PBR);

- Elevated governance and documentation expectations from auditors (internal and external); and

- Good business practice.

We focus below on assumption governance discussions. For people interested in the assumption development discussions, please refer to our article "A Refreshed Look At Assumption Development" in the June 2015 issue of Product Matters.[2]

FORMAL ASSUMPTION GOVERNANCE COMMITTEES

Companies participating in the calls represented various maturity levels with respect to their governance process. Some are in the beginning stages of setting up a formal governance structure (e.g., newer or smaller companies) while others are already two to three years into the formal governance processes and looking to fine-tune their processes, and still others have been formally revisiting the established process and contemplating larger changes in response to the business and regulatory environment. One area of consensus is that there remains significant room for improvement and a large amount of work ahead. The participants on the calls were very candid on the realities of their existing processes and findings, making it easy to exchange real insights and better understand different practices. How to handle the increased demands is one of the key challenges that we discuss in detail below.

ANATOMY OF ASSUMPTION COMMITTEES

While consensus is that having formal assumption committees is good governance, across the Group there exists a wide variety of committee structures. However, there are common themes about what constitutes "good practices."

The first is the centralization of the assumption review and governance committees, across business functions and business units. Having representatives across various "business silos" promotes consistency that may otherwise be lacking. It's important to note that centralization isn't about giving up control and decision-making authority, or imposing the same assumptions across business or functional areas, but ensuring that consistent standards and processes apply throughout the company and that any differences are identified, logically supported, and documented.

The Group exchanged other ideas on the governance structure:

- Assumption development versus governance groups: The development groups focus on experience studies, PADs, and peer reviews, while the governance groups focus on the time lines, responsibilities, and documentation standards.

- Insurance versus economic assumptions: Different assumption development processes and expertise necessary to properly review the assumptions could warrant separate governance committees for insurance versus economic assumptions.

- Working versus approval groups: Identify a working group that handles much of the initial iterations of assumption reviews and a separate approval group that handles the final review and approval.

- Stakeholder representation: The governance committees can achieve a balanced view by having representatives across different groups so that decisions are not dominated by certain groups or views. Early involvement of senior management in the review process is key to a more efficient approval process.

- Three lines of defense: A structure often used in large organizations includes divisional technical review and peer review, ERM in-depth review, and audit independent validation. It may be a challenge to coordinate the three lines of defense to avoid duplicating efforts.

- Model governance is closely related to and sometimes overlaps with assumption governance's goals; accordingly, model governance roles and responsibilities should be clear to avoid any gap and duplication. For example, it's important that the approved assumptions are actually implemented as intended in all the models that should use the assumption. At times, an approved assumption (e.g., expenses) needs to be translated into different formats and structures for input to different models ("assumptions of assumptions"); these different assumptions should be reviewed and documented. These tasks and documentation responsibilities may fall under the oversight of the assumption governance committee.

For smaller insurance companies such distinctions may be less meaningful, but they have other unique challenges. The Group plans to continue hosting calls for actuaries from smaller insurance companies in 2015.

BUREAUCRATIC OVERLOAD?

As additional committees and approval bodies come into being, an obvious question comes to mind: Does good governance necessarily introduce bureaucracy and red tape that significantly slows down the decision-making process?

Experiences that participants shared during the calls suggest that some of them have found that assumption governance actually improves decision-making by promoting ongoing involvement and communication among different groups.

The increasing demand for good documentation was frequently mentioned during the calls. This includes the formalization of approvals and assumption implementations (in contrast to older practices of verbal/email confirmations). For example, auditors often look for meeting minutes and reports to understand if actuaries use a good governance process in setting the assumptions. While such a process requires extra work, particularly for actuaries who are not accustomed to thorough documentation, the benefits can far outweigh the additional time required:

- Improve risk management: Enforcing an inventory and documentation of the assumptions draws attention to the areas that were easy to overlook (e.g., older models with assumptions that do not have supporting documentation and may not have been reviewed or updated for many years). Properly documenting assumptions also reduces key-person risk.

- Meet stakeholder needs: Good documentation can be re-used to meet the demands of different stakeholders, including senior management, state and federal regulators, and internal and external auditors.

- Prepare for PBR: Participants expect increasing demands for documentation to support future PBR processes.

Having a formalized template to document and review assumptions is one method to help ensure a more consistent and efficient process. The Group plans to schedule further discussion on this topic in 2015 and we welcome your contributions.

COPING WITH THE INCREASED DEMANDS

A challenge many participants cited is general environmental change. In other words, the formalization

of assumption committees and increased engagement with senior management has led to significantly increased demands on actuaries to perform additional analysis, fill in any perceived gaps, and in general answer many questions about the assumptions. The Group discussed how best to adapt to the increased demands.

Some participants noted that a formal structure facilitates better engagement and transparency with senior management (which can help actuarial departments more readily justify additional resource requests). Another option suggested was to consider how the assumption governance process can be effectively "triaged." For example, are there ways to categorize the different assumptions into different materiality levels (whether quantitative or qualitative) to allocate resources more efficiently? Should there be varying "tiers" of review, perhaps at different levels of the organization or based on assumption importance, business size and risk, or the level of judgment involved?

A related governance topic is whether or not quantifications of the financial impacts should be reviewed before determining the assumptions, or whether it's better to have independent assumption development processes to protect against potential biases in assumption setting. This is an evolving area and even with the best governance, there are situations where assumptions remain more art than science, especially when credibility is limited. While different methods have been tested, it does not appear that a consensus on what may be a "good" approach has emerged yet.

LOOKING AHEAD

We expect 2015 to be another busy year for actuaries who have assumption development and governance responsibilities. Many Group participants plan to continue building their assumption inventories and fill in any remaining gaps. Those with a more complete inventory plan to begin categorizing the assumptions to better establish the differences between their best estimate assumptions versus prudent assumptions, and what margins are embedded across the assumptions.

Many participants also expect to expand their use of predictive analytics, considering the advent of increasingly diverse data sets and sophisticated statistical models. It will be interesting to see how this may affect the governance processes. The increased use of data science for assumption development is covered in more detail in our aforementioned article, "A Refreshed Look At Assumption Development," in *Product Matters*.

GET IN TOUCH

Discussions take place quarterly. If you are interested in participating or just being in the loop, please contact Liz Olson at *olsonl@nationwide.com* or 614.249.0605 to get on the distribution list. There is no on-going commitment. Also, please look for our group on LinkedIn by searching for "SOA Assumption Development." ∎

ENDNOTES

[1] The Group is sponsored by the Financial Reporting and Product Development Sections.

[2] *Product Matters* newsletters can be found on the SOA website: *https://www.soa.org/news-and-publications/newsletters/product-development/pub-product-development-details.aspx*