1989 VALUATION ACTUARY
SYMPOSIUM PROCEEDINGS

WHY HAVE A VALUATION ACTUARY IN THE LIFE/HEALTH BUSINESS?

MR. JOSEPH J. BUFF: The slides following this discussion present an overview of the issue: Why do many insurance experts feel that it would be useful to have a valuation actuary in the life/health business?

This is a complex question, that can be answered in two parts:

a. What need is to be served by a valuation actuary?

b. What work does a valuation actuary actually do?

Briefly, the concept of the valuation actuary has arisen to provide a mechanism for professional analysis of the adequacy of reserves, and accompanying assets, to support the liabilities of a life insurance company. Assurance as to this adequacy is important today, because of the many financial risks to which a life company may be exposed over time. Lack of this fundamental "reserves and accompanying assets" adequacy would seem to suggest a fundamental weakness in the financial structure of the company.

The work of the valuation actuary is coming to be defined more specifically, as the result of several industry research and working groups. The NAIC Life and Health Actuarial Task Force has been addressing possible new laws and regulations for statutory valuation procedures. This NAIC Task Force is being advised by an industry group called the Special Advisory Committee on the Standard Valuation Law.

Some proposed changes to the Standard Valuation Law have been circulated for discussion. They are based on the following overall framework:

a. A qualified actuary would periodically render an opinion, as part of ongoing regulatory compliance with statutory reporting.

b. The opinion would address the adequacy of reserves and supporting assets to fully mature the various obligations of the company.

c. The opinion would be supported by a separate confidential document, an Actuarial Memorandum, detailing the checks and calculations relied upon by the qualified actuary in forming his or her opinion.

In general, the approach taken by the Task Force and the Advisory Committee is that laws, which are difficult to change, should contain a minimum of detail. Rather, maximum flexibility should be allowed for in the drafting of implementing regulations.

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How much work needs to go into an Actuarial Memorandum? Standards of practice need to be reviewed. Although cash flow scenario testing may be the primary route to take for many companies and many products, alternatives do exist. Generally, the extent of the analysis of reserve and asset adequacy should be guided by the degree of risk exposure. Surplus is not to be addressed directly in a new Standard Valuation Law in the near future, according to the prevailing view as this speaker understands it.

Reserve adequacy is a question of degree. Thus, professional judgment is called for. A number of techniques exist for assessing adequacy, as discussed on the slides. Again, professional judgment would be called for in choosing the appropriate techniques to fit a particular set of circumstances.

Smaller companies should not be overburdened by unnecessary analysis. As a working principle, many feel that the qualified actuary's analysis should only be refined to the degree that a refinement could actually alter the opinion itself. That is, special refinements which are not directly material to the actuary's opinion ought not to be necessary for regulatory compliance.

Special considerations apply in the case of reinsurance. The mandatory securities valuation reserve (MSVR) is another matter for special consideration. The MSVR may best be treated separately from the question of possible changes to the Standard Valuation Law. The presentation ends with a brief review of some issues relating to the MSVR.

Standards of Practice

- Analysis as function of risk
- Reserves, not surplus
- Materiality

Cash flow scenario testing for:

- Significant reinvestment risk
- Mismatched asset strategy
- Risk not well understood
- Book value policy withdrawals
- Fast growing blocks

Scenario Testing Unnecessary for:

- Mature, insensitive business
- C-4 risk
- Modest reinvestment risk
- No material changes since previous testing indicated adequacy

What is "Reserve Adequacy"?

- Substantially better than even chance
- But not under catastrophic conditions

Techniques

- A priori arguments
- Demonstration of conservatism
- Multi-scenario cash flow testing
- C-2 risk methods
- Other approaches?

Choosing Techniques

- Type and severity of asset and/or reserve risks
- Avoid unnecessary refinements
- Compare asset and liability features
- Sensitivity testing

Smaller Company Considerations

- "It is only necessary to refine analysis to point wherein judgment of opining actuary, further refinement would not alter opinion."
- Provision for regulatory relief

Reinsurance

- ASB Proposed Standards of Practice
- Look through reinsurance to underlying cash flows
- Recoverability from reinsurer
- Other approaches?

Mandatory Securities Valuation Reserve

- Provide for default risk
- Stabilize surplus from investments
- More discussion needed

Committee MSVR Proposal

Default Risk

- Investment income "shaves"
- Use portion of MSVR

Committee MSVR Proposal

Surplus Stabilization

- Reserve strengthening
- Capital gain
- Transfer from MSVR to reserve