2004 Valuation Actuary Symposium*

Boston, MA
September 20-21, 2004

Session 17 OF
Optimizing the Valuation Process

Moderator: Meredith Ratajczak

Panelists: Stephen L. Marco

Summary: Panelists discuss prevailing business models (as well as the role of the home office) adopted by valuation departments to meet business needs. Potential business models include decentralized subsidiary model, centralized hub, outsourced to external vendor and hybrid.

MS. MEREDITH RATAJCZAK: I've been with Milliman for 17 years. I've spent my entire career at Milliman doing valuation-related things, whether that's cash-flow testing or calculating reserves. My co-panelist is Steve Marco, and he's managing actuary at Genworth Financial. He can give you a little bit more of his background. I also include the audience as the other panelists for this session. For a session such as this, don't think that Steve and I are going to stand up here and say, "Here's how you do it." We can't do that, based on some of the survey responses that we got. Granted there are specific things that people think of when talking about optimizing the valuation process, but depending on how your valuation function is structured within your company, what works for you may not work for somebody else.

The SOA has had sessions like this before, and I went back and looked at both of those sessions. It was interesting. They were both totally different, so we thought we would do something a little different again this time. We wanted to have a different focus than last year and not make it so formal. This is an open forum. We hope that our audience will participate. If not, we'll be done early, and you can go off, but we hope that you will get up and speak so that we can share our thoughts and experiences on optimizing the valuation process.

How are we going to be different this time? The basis for our discussion today is the summary of the responses that I got from the e-mail survey that I sent out to everybody. There were six questions on that survey, and I thank those of you who did respond to it. What I was interested in doing was getting some of your thoughts on some questions. If you looked at the session description, it gave a list of business models, including decentralized hub, centralized and hybrid. I wanted to get a sense of how your company is set up in terms of the valuation process. Does that model work for you? Is it optimal? How would you describe "best in class?" That means different things to different people. What does the expression "optimizing the valuation process" mean to you? Does your company use the same projection models for all purposes? How has Sarbanes-Oxley (SOX) changed your company's valuation process for the good or for the bad?

At the time I sent out the survey there were 53 individuals signed up for this session, so I sent the e-mail to them. About 25 percent of the people who got the survey responded to it. I wouldn't consider that an overwhelming majority, but it did offer a lot of diverse answers to the six questions that we asked. As I said, we can't say, "Here's how you should do things to have an optimal valuation process." Throughout this discussion, when you see people's survey responses, you'll see a lot of the same words over and over again: "timely," "efficient," "accurate," "easy to follow" and "not using a lot of resources." Those are the types of things that you think of when you think about optimizing the valuation process.

Can you have a timely process that is 100 percent accurate? I'd say yes. Are you able to make efficient use of resources, or do you have enough resources to be timely and accurate? Some people said yes, and some people said no. We can talk about people's experiences and how they answered those questions. We hope that those who did not respond to the survey might be willing to get up and share some of their thoughts and observations with us. As I said, there are basic things that make any process optimal. I specifically asked the question about using one set of models for your process. Some people do, and some people don't. Being able to leverage off of the updating that's done and the changes that are done in one system could make your valuation process that much more optimal.

Moving on to the first question, I'll let Steve talk.

MR. STEPHEN L. MARCO: We'll talk about valuation models currently in use. I'll give you a little background. I work at Genworth Financial, which up until this year was known as GE Financial. We got into the insurance business roughly 10 to 12 years ago by buying a number of insurance companies. As a result, we have well-established processes in a number of different areas. I would consider that decentralized because each area works virtually independently in terms of producing its cash-flow testing, its asset adequacy analysis and whatever reserve analytics it does. It has worked out well for us, but we feel, especially since I'm one of the corporate actuaries, that we could probably do it better if we brought everything in-house into the corporate area. For those of you here who are in a similar situation, I'd like to know how you would address that circumstance where you have a number of sites and how you would change the culture to allow that to be brought into one central location.

MR. JEFFREY K. SMITH: In the 27 years that I've been with MetLife, about half my time was as an actuary and the other half was not as an actuary. Right now I am in a valuation actuary position again. When I hear the question you raise, it makes me think of one of the non-actuarial roles that I had, but the model, in my mind, fits just as well. We had had at MetLife 20 bill-paying sites across the country, each doing things its own way, processing a total of about 500,000 bills per year. That contrasts to other companies. Sears would do perhaps 20 million bills at one site, and we would do 500,000 spread across 20 sites. We looked into it for reasons of efficiency and control.

In terms of what you have to do to change the culture, I'd say it was a two-step process. The first thing was going out on road trips to understand how everyone processed things differently. I started out with an open-mind, thinking that we could have 20 votes and raise them all to one high level. I experienced and looked at a number of stores. What my little road trips proved to me was that if you have one vote, you might be able to get at a high level. If you have two votes or 20 votes, they will never be at the same level. I became convinced that you couldn't have 20 votes at a high level; no one was so open-minded about it. There was no way to convince the individual sites that that was the right way because they all felt their work was different and their way was the best, even if we had data showing that not to be the case.

The only thing that drove it at the end of the day was senior management deciding that we were going to do it and there were no questions about it. That didn't necessarily change the culture, which is the way you phrased the question. It was the only way to get it done, and in fact we wound up with one bill-paying site that we started up new. We didn't even use one of the existing ones. We have it done now for a lower cost and very efficiently and successfully. It's no longer the butt of all the complaints: "Why did my expense voucher never get paid?"

I would like to share one anecdote. This proved to me that you couldn't do 20 sites at one high level. We went to one site that had an efficient process. We went to another site that had an inefficient process, as we measured it with various statistics and listened to their stories. I couldn't understand it, and so we said to the one site, "How did you ever learn to do it this way?" We said it more diplomatically than that. Its answer was, and it named the other site that was the best, "It taught us." That didn't make any sense. We went back to that first site and said, "Is it true that you taught the people at that site?" Its answer was intriguing. "Yes, we taught them. We taught them when we had the old process, and then we decided it was inefficient, and we changed it, but we never told them." That was one of the many stories I heard at 20 sites that proved to me that you can't let them all decide and then do it.

MR. MARCO: In our case we got a number of comments, and one comment was, "You would want each site that has a particular expertise to do things the way it feels is the best even if it appears to be different from everybody else." Our sites are structured so that they are distinguishable by product type, so you'll have area term in universal life (UL), you'll have a group area and you'll have an annuity area. Each area feels that it's got the handle on how to do it properly. When it comes to things like valuation or cash-flow testing, we're on a number of different actuarial platforms, so each one feels for whatever reason that the platform it's currently on has certain advantages over others. The challenge for us is try to get everybody on the same page. That's selfish on my part because when you roll things up to corporate, it makes life a lot easier if we're all doing it the same way.

MS. RATAJCZAK: The survey indicated that all of those different processes or structures are currently in use by the companies represented here, and some companies use a collection of those within the company. The most-mentioned valuation process models currently in use are centralized and decentralized hub structures. That's what the survey said.

FROM THE FLOOR: I wanted to comment on your last statement that as a corporate actuary, it makes it difficult if all sites are using different methodologies or different systems. I think that you can strike a nice middle ground between bringing it all into the corporate actuarial area and leaving it all in the sites. The middle ground would be having strong leadership at the corporate area to specify the projection systems or whatever you're going to use, but then work with the different divisions to implement those systems so that you can roll it up effectively and officially in corporate.

I used to work for AEGON/Transamerica Reinsurance, which has a decentralized environment, and it seems to work well for the divisions. I was never in the corporate area, but I know that AEGON had specified across the board, "These are the systems that you're going to use for cash-flow testing, and that's it. There's no discussion." Ultimately, Transamerica started moving away from that, and it became a big challenge for AEGON's corporate area, so I offer that as a possible middle ground between bringing it all internally and leaving it all externally. You can have some good leadership and have a process that works better than either one of the others.

MR. MARCO: In other words, what you're suggesting is requiring that certain platforms and certain approaches be taken. Corporate will require that, and it flows down to the individual sites.

MR. ROLAND R. ROSE: I am a valuation actuary for Guardian's reinsurance subsidiaries. Reinsurance is considered to be a profit center. The different profit centers do their cash-flow testing, and generally the profit centers are different from each other because of product. It's centralized within a product, and the different cash-flow testing and valuation work as decentralized across different products. I still see, though, that in the reinsurance we have different companies and different TPAs, and so in a sense we centralize that, but our reinsurance business is so different from our individual life business that it's a different product.

MR. MARCO: Does that mean that the approaches you take would necessarily have to be different? For example, you have different software packages to do your testing?

MR. ROSE: No, not at all. Admittedly this is something that needs to be worked out, because what happens is that cash-flow testing for individual markets evolved from different people who had different software expertise, and then, for instance, the reinsurance evolved from people who worked with other types of software. It seems that it has been difficult to come to a unified software position. It's hard because there may be reasons for why you prefer a certain type of software. You may be using some software that is more frequently used in the industry than the software that the other profit center is using, even though it's doing life insurance business as well. That is a tough thing to deal with, and it's hard to make that go away.

MS. RATAJCZAK: I've seen companies that use different platforms across the company, and the key is that they have put good processes in place to put that information somewhere and roll it all up in one place. That's looking at companies whose process works well, so that they're using different systems for different reasons. They have a well-defined process for taking those results, putting them together and presenting them in such a way that management can make heads or tails out of that information. We talk about optimizing and resources. There aren't always enough resources to go in and move everybody off of many different platforms. In that case, the key to optimizing is having good processes in place to control the information flow and produce meaningful reports that are coming out for management.

Thinking about the company you're with now, raise your hand if during the time that you've been at the company there has been a change in the way in which the valuation process has been modeled. For example, at one point you used a more centralized structure, and now you use something that's decentralized. That has happened for about 25 percent of the audience.

MR. MARCO: Has the change gone from a centralized to a decentralized or the other way around?

FROM THE FLOOR: Centralized to decentralized and back to centralized.

MS. RATAJCZAK: Let's move to the second question. Given whatever your current structure is, would you consider it optimal (however you want to define "optimal")? We had a number of "yes" responses. One person indicated that for the time being it's working fine. Who knows in the future whether that will change or not? Other individuals felt that it's not quite optimal. Some people feel they don't have enough resources to get the job done. "It's difficult to make it optimal if you are having a hard time satisfying what everybody needs to get out of that process." "There needs to be more talking between cash-flow testing and valuation and more communication from a flow-of-information efficiency standpoint." One respondent said, "No, it would make more sense if the corporate group would review and coordinate everything," so it would require getting more toward a structure where you've got a central group that is reviewing the materials. Another respondent said, "No, it's hard to keep all models updated in a timely fashion," which is getting back to the resource control issue.

There were a few more "no" responses because the documentation is hard to follow. It's not easy. Some people want an easy valuation process. Another person said he's not sure what "optimal" is and is not sure whether his company's process is optimal or not, and one person offered a "no comment" on that question.

MR. MARCO: One way of looking at whether it's optimal or not, at least to my way of thinking, is if you think of having a single model that satisfies all of your modeling needs, be it cash-flow testing, be it asset adequacy, be it deferred acquisition cost (DAC) recoverability or be it GAAP projections, and that particular system is maintainable and easily updated, to me that's an optimal system. Are there any comments?

FROM THE FLOOR: We have basically two models: projection models and valuation models. Recently we've been able to follow fairly closely that the one model can reproduce the other model in the next two valuations in your dates, but it's based on what their multiple valuation process. It can go beyond the efficiency of the model itself. Can the models not only give you information that is statutorily required or required for GAAP or whatever, but at the same time give you information that your business leaders can use at the same time? Particularly for a small organization, you need to kill two birds with one stone, so I think of our valuation process as one that not only gives you what you need to fulfill your compliance requirements, but also gives you information to manage the business at the same time.

MR. MARCO: Source of earnings would be readily available on a projected basis. A natural basis would be another story.

MS. RATAJCZAK: Getting back to what is "optimal," I would assume that actuaries practicing in the valuation area would have possibly a different definition of "optimal" than the senior management that is getting what you are producing out of that process. When we talk about optimizing the valuation process, you have to think about who we are optimizing it for—for ourselves or for management—and those two might not necessarily go together. Management wants it fast and right, and that might not be going...

FROM THE FLOOR: You've got special requirements by the actuary that the information has to be accurate and comply with everything that's legally required. At the same time, senior management is interested in growing the business and the best way to that. As an employee, you have the balance that.
MS. RATAJCZAK: I agree. Steve, do you want to talk about "best in class"?

MR. MARCO: It depends on your definition of "best in class." I described a little earlier what I thought an optimal system was. Best in class would probably take it a step further. For example, if you're doing cash-flow testing, do you have automatic downloads from your administrative system to populate your model for the current year? If you're doing a valuation, do you have some automated way of looking at analytics? I don't know how many people look at average reserves per policy or per $1,000 anymore, but that was a mainstay, and that's something that I've always done. It became something of a logistical nightmare to get all of that data unless you could figure out some simple, downloaded way to do it. When I talk about that particular topic "best in class," that's what comes to my mind: efficiency, getting it done quickly, getting it done right and getting your deadlines satisfied.

MS. RATAJCZAK: Here are some of the responses from the survey. We had a "no comment." "Good question; I don't have the answer." "Neither one. That's why I'm here: to find out what best in class is." "Beats me." "Not sure." Some other answers tie in with what Steve was talking about. It's a process that's tied together, that could be efficient and has good controls in place. It's a process that values all business and is verifiable, efficient, easily adapted to new products and timely. Those are big shoes to fill. It's fully integrated between administrative and valuation, easy to use, requires minimal use of computing resources, is up to date and provides audit trails.

MR. MARTIN E. UHL: What we've run into most of all in the past couple of years (the hardest problems from my point of view of valuation have always been real-world problems) is where the valuation in the system will assume that a death benefit has been paid and you don't do a reserve, and yet your accounting system hasn't paid the death benefit. You often have a mismatch between your Oracle system and your valuation extract files. We've spent the past couple of years trying to tie together the accounting areas of cash flows and real-world issues with what are pie-in–the-sky reserve system things that actually happen.

A few years ago in payout annuities, millions of dollars of payments would be sent over to the accounting department and get stuck somewhere in the process. The reserve system would think the payments had been made when they hadn't been, so we spent a lot of time getting together with the accounting department on what we'd call "manual adjustments." The latest wrinkle was trying to tie together our suspense system of payments that have been stuck somewhere, or they were actually paid but the suspense things are still in suspense. We've been trying to balance this to see how we can, on a timely basis every month, get our reserves absolutely correct.

We talked about doing average reserve per $1,000 and things like that, but if you have several million dollars or a couple billion dollars of reserves, you can miss a couple of million dollars and it wouldn't show up in a ratio. I think this is a better approach, but it has been hard talking to the accountants and getting their suspense and our reserve system in sync. We've been getting better at it, but it has been difficult. I think a best-in-class system would be something that does that automatically every month. It would look at what the reserve system assumes happened versus what actually happened.

MR. MARCO: For example, reserves are released.

MS. RATAJCZAK: Does anybody else want to share initiatives of your company that you're doing now or have done, in terms of what you feel gets your company closer to what might be best in class?

MR. ROGER EUGENE FROST: We had a situation like he described. We would have our reserve bank questioned because relative to the accounting data, it didn't look right. For example, on pending death claims, we look to see what actually had been paid already. The first time we tried that, we found $700,000 that had been paid, but we hadn't taken the policy out of force. We have done a lot of what he was talking about. We did tie the accounting and the valuation data together. We look at things on a policy-by-policy basis and pick out things that look funny. We do have people in the financial area and actuarial area that know a lot more about the accounting system on more of a detailed level than some of the accountants do. It's not for everyone, but it has helped us.

MS. RATAJCZAK: I'm familiar with one smaller company that went through an initiative about a year ago setting up a series of all these Excel spreadsheets that hook together and information that came out of their asset adequacy testing. It even has a GAAP version of that, where it has certain control-check features in the spreadsheet to make sure that what is coming from the accounting people ties to what they are using in terms of reserves. There were certain flags set up that say, "Should match," or "Doesn't match." The company does it religiously on a quarterly basis, and it's able to use it also to look at trends. It put in some ratios so it can check to make sure that nothing looks too out of line. At one point in time it didn't have good control on that information flow, and now it has a way to at least focus on it to make sure that it's getting decent information from administration and from valuation, because it needs both of those systems to be perfectly in sync so that it doesn't get out of line.

MR. MARCO: One thing that I would think of in terms of optimizing the process would be a process that you could use for more than valuation. For example, one thing I've done in the past is use the dynamic validation process for cash-flow testing as a quick-and-dirty mortality study for a number of my blocks. Depending upon the granularity with which you're willing to work, you can get down pretty far with it. I'm curious whether anybody has tried doing that here.

FROM THE FLOOR: My company did use the model in the cash-flow testing as a jump-off point to create a business, a model for projection purposes for business operating five-year trends. None of it was aggregated or hooped together perfectly for the cash-flow purposes, but the person whom I worked with, another actuary, was able to use a model massaging it and build a business model that we're now using to do three- to five-year projections of what is going on. Those are all from the cash-flow testing.

MR. MARCO: I was referring to, for example, a pricing exercise, where you're looking to analyze a block of business that you've already written. Typically when you do cash flow, you normally do it by plain code or some grouping of similar plain codes. Depending upon whether you want to break it down by issue age, duration or attained age, you can come up with actual-to-expected based upon your assumed mortality within the model. That can go a long way to helping a pricing actuary key into how to refine a product, especially if your resources are so limited that you don't have the time to do a full-blown analysis.

FROM THE FLOOR: In our circumstances, they do that off of a valuation system that they connect with the valuation module, so that capability to get actual perspective and confidence intervals is all there.

MR. MARCO: In our case we used to use TASS. This was a number of years ago. We found it to be a good way of doing an off-the-cuff mortality study.

MS. RATAJCZAK: There are a few more responses to the survey regarding best in class. Somebody indicated "judged on results, not on structure" and wants "speed, accuracy and the ability to leverage the valuation process to provide other relevant information." "One suite of software that does it all." "One that produces information useful to management in managing the business." "A system or process that allows for continuous improvement," and is "timely, fast, accurate, controlled, simple, based on current technology, flexible and well-documented." "A system that answers management's questions in a timely manner and satisfies year-end reporting requirements." Those are all good answers to that question. We had a "Depends," and a "System that does what it's supposed to do, when it's supposed to do it."

We asked the question, "When you hear 'optimizing the valuation process,' what does that mean to you?" It was clear to us from the past couple of times that the SOA had this session, it meant different things to the panelists. Some of the survey answers were, "Changing the process so information is readily available, the system is efficient and controls are in place." "Cut down the time, and improve the quality." "Make the system dynamic, responsive and self-adjusting." "Improve the accuracy of estimating reserves with minimal additional time and resources." "Lowest possible reserves with documented regulatory compliance with fewest devoted resources." "Improve speed and accuracy." "Get the most efficient process to comply with statutory/business reporting requirements on a timely basis while leveraging the work product." "Get value out of the valuation area." "Quality, quantity and time." "Make it efficient and timely." "Ability to provide valuation and answers in a timely manner." "Make it efficient, accurate and educational using the fewest resources possible."

That leads me to my question: Can a valuation process be optimal and not be best in class? That depends. If you think about people's definition of "best in class" and "optimal," some of those things are hard to achieve. I think you would say that if a company or department is best in class, its process is probably optimal for its purposes.

FROM THE FLOOR: You have a process that's quick and accurate. You have numbers that are accurate and that comply, but if it is not communicated in the right way to the right parties everybody doesn't understand it in the right perspective, you may be the only one who thinks it's possible.

MS. RATAJCZAK: That's right. If you have limited resources to satisfy all of your regular reporting requirements and to get management what it needs, you may or may not be able to do all the bells and whistles such that whoever you're getting information for feels that it's best in class. The issue is that there are different perceptions on what these two things mean, depending on whether you're the doer or whether you're the user of the information. From the standpoint of the people who are in the trenches doing the work and are responsible for the process, having best in class and optimal will work just fine. You want accuracy, you want timeliness and you want to satisfy your corporate reporting deadlines. However, the people to whom you give it might have different ideas of what's timely. "Timely" to you may mean meeting those deadlines.

FROM THE FLOOR: What did the information say? From your perspective you say, "I understand." Someone else looks at it and says, "We have a different discipline involved in the reporting process." You were talking about accountants, other management types, and you always have to spend as much time building an appropriate team and an appropriate communication process.

MR. MARCO: Another example when I think of best in class might be an organization that uses a current-generation actuarial platform, one that can do stochastics and all of the types of things that would impress somebody who had been used to doing something with TASS 10 or 15 years ago. We have some areas of the company that specialize in group business, and quite frankly they don't need Moses or Alpha or any of those kinds of packages. They can do a fairly good job using Excel spreadsheets and a few homegrown programs. I would say they're not best in class, but in our case they come out to be optimal.

MS. RATAJCZAK: For their purposes, that might be their definition of "best in class" because using Excel spreadsheets makes a lot more sense to them than using one platform to do everything.

MR. MARCO: True.

MS. RATAJCZAK: Do you have a well-defined process in place for rolling those things together, given that you do use different platforms?

MR. MARCO: No, we're working on trying to develop that.

MS. RATAJCZAK: I asked the question, "Has Sarbanes-Oxley changed your valuation process?" The answers to this question were interesting. Some people felt it makes their process more optimal. Then we had a response such as, "It increases the time to complete tasks, but it has made the current process more optimal." The issue of timeliness seems to have put strains on groups that are responsible for putting all the documentation together, but there was a general sense that putting the control and the rigor in place to do the documentation has added to optimizing the valuation process.

Sarbanes-Oxley hasn't impacted some companies at all. "Not sure." "Pushed us to prepare more complete documentation." "Made it a little less optimal." "Made the process more scheduled." From a time standpoint, you had to get things done at a particular time to meet internal deadlines. "Better controls and more documentation—viewed as improving the process." "SOX has made the process less optimal because of documentation requirements." "SOX has made the process less optimal since it has taken away resources from the valuation process."

We get to the question, "Does your company use the same projection models for everything?" Some say yes, and some say no, and we know that there are a lot of reasons why people use one platform or use multiple platforms. It takes a large resource commitment if you decide you're going to take all those Excel spreadsheets and move them to a different platform. You get people who are comfortable using those particular models, and the thought of "I've got to build this new thing, and I've got to validate it" means taking away resources, and part of their definition of "optimal" isn't necessarily using those resources to do it.

The reason I asked this question is that we always talk about leveraging—being able to leverage the resource commitment that you've put toward the valuation process. Having multiple models where you have to update assumptions for the same assumptions three or four different times is not necessarily optimal, and you might not be making the best use of your resources. The question was asked to assess your company's ability to leverage the work.

When they defined "optimal" or "best in class," some people mentioned being able to leverage what was coming out of the system. If you can leverage what's coming out of your system, it might also help to have management's vision that your system is optimal because maybe you're able to provide management with things quicker, and maybe it's more accurate. Having one model makes it easier to update the process and may make it easier to control the process. Are you able to use one model? Maybe or maybe not. It depends on whether one model makes sense for the type of business that you have. There are constraints.

MR. MARCO: A lot of it depends also upon how your shop is set up. For example, if you're going to use one model for both cash-flow and financial projections, that would mean you'd have a fairly large cash-flow model, because most people try to do projections on a quarterly basis and end up with much bigger models to do that. You'll have run-time considerations that you might not have otherwise. Also, you might have other parts of the company doing that work. How do you get them all to talk to each other? How do you get them to agree to use the same model? In our case we have a couple of those situations. It becomes an effort to do that. Sometimes you find differences of opinion in assumptions between the valuation actuary and the people doing the projections. You've got to nail that down and that's not always as easy as it sounds, so there are some reasons why it's difficult to do that. Having said that, I once worked in an area where we did have a unified model, and it did make life a lot easier going back and forth.

MS. RATAJCZAK: From a control standpoint or from every standpoint?

MR. MARCO: From every standpoint. Maintenance took a little longer, but if you consider the fact that each model would have to be maintained separately if done separately, the extra time on the somewhat bigger model netted out to be a lot less. Again, the logistics were, who does what and who is willing to concede on what point when it comes to assumptions?

MS. RATAJCZAK: There are certain words that we keep hearing when we talk about optimizing the valuation process: efficient, accurate, timely, easy, dynamic and controlled. We heard that resonate in all of the answers to the questions that I asked. Whether you can do all of those things at the same time depends on how you're structured and on your resources. In the back of your mind when you think about optimizing, you are making changes to your system to achieve efficiency and accuracy. Judging from the work that I've done with companies and looking at them, everybody would like nothing more than to have the optimal valuation process. A lot of companies work toward doing what they can to put controls in place to allow them to have that.

For those of you who attended the first session this morning, "Life and Annuity Valuation Issues," if you think about the types of things that are going on in our industry in terms of the way in which we will be looking at the valuation process, it will get more difficult to do these things. For example, the stochastic valuation process is being talked about on the UL side potentially using model-based methods to set reserve levels. I can tell you from experience, few companies have to do the

C-1 testing. I know of one company that did. When you are using the numbers that are coming out of the model to set things such as risk-based capital (RBC) and reserves and are looking at how the results compared to last year generally, I can assure you that you will end up spending much more time looking at the nitty-gritty numbers that are coming out because it's going to make a difference as to what you show on your statement.

We use models to do asset adequacy testing. We saw the results of the survey. Twenty-five percent of the companies have had to put up reserves as a result of asset adequacy testing. So you do your testing, look at results, compare them to last year and decide whether they make sense. Think about how much detailed checking you do as the person who is reviewing the numbers. When you move to a process where you are doing projections and using conditional tail expectation to set the reserve numbers that are going to be on your statement, being able to do things in a timely fashion may be a challenge. It's more taxing on your resources because what you're doing is going to be important and is going to impact what goes on the financial statement.

As we move toward doing the valuation process using model-based approaches, it's going to change how we view "optimal." For those companies that are doing their valuation work as of December 31, it will be difficult to do the C-3 Phase II testing or set reserves on December 31. That's why they're having these discussions about whether you can use prior periods and how you update them. This is something to keep in mind regarding our industry and the changes that are going to be happening in our valuation process. It makes these words, which describe optimizing the valuation process, important, but they're going to be at cross-purposes with one another. Looking at results of 50 scenarios is different from doing 1,000 scenarios. Especially when you're looking at tails, it's difficult to get your arms around those numbers without spending a lot of time doing them. Optimizing is going to be more difficult in the future.

Those are our six questions to you. Now we'll throw the floor open to you, and you can ask us your questions.

FROM THE FLOOR: Somebody in one of the sites said that SOX or the documentation slowed down the optimality of the process. My perspective is that it depends on what you think is included in the universal process. I think being included in the universal process is some external audit or some kind of audit view or examination—whether it's the state or whether it's your external auditor—and you document up front. Our documentation isn't perfect, but it's always a work in progress. It may seem that you're slowing down now, but your audit could be hell if your documentation is not sufficient, so it may depend on the perspective of what you think is the process. You always have to keep in mind what you think the auditor is going to say.

MS. RATAJCZAK: Are there any other comments?

FROM THE FLOOR: Do you see more benefits to cash-flow testing from different products together at the corporate?

MR. MARCO: I do. In many cases you have certain corporate targets you'd like to meet, and only a good corporate projection can give you a feel as to how readily you can meet those targets. Our plans are to do something along those lines at some future point. As part of the Genworth IPO we have certain conditions that have to be met and certain targets to be met, and by putting together a good financial projection we can see whether we're on track to do that or not. If for some reason we're not on track, we'll know what we have to do to get there. I don't see how you can do that unless you can roll everything up at the corporate level.

MS. RATAJCZAK: From a cash-flow testing standpoint, depending on what type of aggregation method you're doing, it would be difficult if you had a central appointed actuary in multiple units doing testing if the appointed actuary is going to opine on the reserves. Suppose he looked at interim results. It probably would be more efficient for that appointed actuary who sits on top of everybody to have an aggregated way of looking at the results.

In many large companies I've seen a structure where you've got the various product areas doing their own cash-flow testing. A responsible person does the memorandum, and that's applied to the appointed actuary, who might do something that goes to the board, which does its opinion. For the companies that I've looked at, that process seems to work well. In those companies where it works well, the key is good communication between the various units.

Typically, the investment department supplies the investment stuff to each of the units. They're not doing it themselves, so you've got one set of asset cash flows or assumptions that they're working with, but then they supply this information to the appointed actuary, who goes through a review process. I've seen that work well for many large companies. From a resource standpoint, that seems to work well for them. I've also seen other large companies that have a valuation unit that does it all, and that works well for them. I think if you were to ask those companies, they would tell you that they feel they're well on the road to being optimal, and that seems to work well for their particular companies.

FROM THE FLOOR: You said you're moving toward the stochastic valuation process where you're modeling more than using actual data. Of course, your model shows cash-flow testing, but if you're going to use it for valuation itself, how granular do you have to get to get an appropriate fit? The whole cost method analysis of trying to get a good fit becomes important in getting good valuation. In your experience, how often would you revisit that, or revisit that in your data—quarterly, monthly—?

MS. RATAJCZAK: A lot of it depends on how often you run those models. I've seen companies run those models quarterly, and they take a look at whatever.

FROM THE FLOOR: My first thought was that you'd probably have to do it quarterly.

MS. RATAJCZAK: However, I know other companies that focus on model changes once a year, and that's what works best for them. In that particular situation, they might look at certain metrics as they're going along to make sure that nothing is getting way out of line.

FROM THE FLOOR: T They do a much smaller version or look at some milestones along the way to make sure nothing is out of line.

MS. RATAJCZAK: Even those companies that run quarterly may monitor experience assumptions quarterly but not make any major model changes until the end of the year. I've seen companies going both ways. Probably more often they change assumptions rather than the actual model, unless maybe they've introduced a new product series, have sold a ton of it and want to get it in the model before year-end. That drives that process, as well.

FROM THE FLOOR: In the answer you just gave, you were referring to annual and quarterly. How much have you seen with companies running their reserves monthly for analytical or other purposes?

MS. RATAJCZAK: Like monthly cash-flow testing?

FROM THE FLOOR: No, the running of the reserves for analysis for earnings purposes.

MS. RATAJCZAK: I know a number of companies that go through that valuation process that have monthly closes. They go through and look at it monthly because management looks at it monthly. They do look closely at what's coming out on a monthly basis.

FROM THE FLOOR: I'd be interested in a show of hands of how many companies are monthly now, and how many went from monthly back to quarterly.

MS. RATAJCZAK: How many of your companies were quarterly or annually and went to monthly?

FROM THE FLOOR: How is that different from the first question?

MR. MARCO: It depends on how far back you go. I'm curious as to why so many companies do monthly financials.

FROM THE FLOOR: It really is an indication of what can happen in the quarter.

MR. MARCO: But are all the reserves truly converted to a monthly basis? I've worked in environments where they purported to do monthly financials, but a lot of the accruals were really done quarterly and extrapolated or interpolated.

FROM THE FLOOR: I wouldn't be the least bit surprised if our direct business is added monthly, but I know that our assumed business could not possibly be done that way.

MR. MARCO: You do have some mixing.

MS. RATAJCZAK: I see more companies going the monthly route for that reason—people don't want to be surprised. You get close to quarter-end, and you don't want to know there's some issue looming. It is more of a control.

FROM THE FLOOR: There's a person in our plant whose job so far is to give the CFO a daily punch.

MS. RATAJCZAK: For those who do monthly, how many have a week or less to do the close? How many have more than a week to do the close? It's evenly split. I see the push to shorter. People want it done quickly, with a five-day close.

FROM THE FLOOR: Of the ones who close monthly, do they close exactly on the end of the month, or do they do the last Friday or earlier? Do they close exactly at month-end no matter what day of the week it falls?

FROM THE FLOOR: You start getting into semantics, don't you? You can value everything to the 31^{st}, but the administrative system stops processing on the 28^{th}. What is that—the 31^{st} or 28^{th}?

FROM THE FLOOR: I meant, when do your books close? Do they close the end of the month, or do they close the last Friday? We always have to have a weekend.

FROM THE FLOOR: I was going to ask the flip side of the question. If you're talking about shorter and shorter time frames, in terms of the planning exercise, how many companies allow one year, two years, five years or maybe even further? Are there any companies that are doing that?

MS. RATAJCZAK: Let's see if I got all that. Let's see a show of hands of people going through a planning process. How many do just a one-year plan? What about a three-year plan? How about a five-year plan? A three-year plan looks like the most common. Why don't you ask your question about embedded value?

FROM THE FLOOR: How many companies are doing embedded value for a long-term type of valuation?

MS. RATAJCZAK: Embedded value? About 25 percent.

FROM THE FLOOR: I wanted to make an observation that goes back to a comment earlier about sources of the earnings being coordinated with valuations and valuable exercises. In Canada, actuaries are going to have to do new sources of earnings, and it's going to have to be disclosed in financial statements this coming year-end for the first time. There's not actually an actuarial opinion involved in it, but it is disclosure, so there's certainly going to have to be good thought put into how that's done.