

ACTUARIAL STANDARDS OF PRACTICE FOR ERM

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Outline

- A) Introduction to Actuarial Standards
- B) ASB ERM Task Force
- C) New ORSA/IRMA Requirements
- D) Discussion Drafts of Standards for
 - Risk Treatment
 - Risk Evaluation
- E) Postscript

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Actuarial Standards of Practice

- ❑ Standards are a true sign of a profession
- ❑ Defines what can be considered true actuarial professional work
- ❑ [Standards address work of the individual actuary](#)
- ❑ Basis for Disciplinary Process
- ❑ Basis for Professional Opinions
 - Tied to regulatory requirements in some situations
 - Provides a way for actuaries to communicate when they are being asked to deviate from normal practices

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Actuarial Standards Board

- ❑ US organization that creates the Actuarial Standards
- ❑ Has existed since 1980's
- ❑ Currently there are over 40 active standards
- ❑ Process is very lively
 - Several standards are revised and updated every year
 - Several standards have been delisted
 - New standards are added
 - Very active comment process

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Actuarial Standards of Practice for US Actuaries (first 10)

1. Nonguaranteed Charges or Benefits for Life Insurance Policies and Annuity Contracts (Doc. No. 092; March 2004)
2. Recommendations for Actuarial Communications Related to Statements of Financial Accounting Standards Nos. 87 and 88 (Doc. No. 004; April 1987)Note: Repeal pending
3. Practices Relating to Continuing Care Retirement Communities (Doc. No. 111; September 2007)
4. Measuring Pension Obligations (Doc. No. 107; September 2007)
5. Incurred Health and Disability Claims (Doc. No. 076; December 2000)
6. Measuring Retiree Group Benefit Obligations (Doc. No. 084; December 2001)
7. Analysis of Life, Health, or Property/Casualty Insurer Cash Flows (Doc. No. 089; June 2002)
8. Regulatory Filings for Health Plan Entities (Doc. No. 100; December 2005)
9. Documentation and Disclosure in Property and Casualty Insurance Ratemaking, Loss Reserving, and Valuations (Doc. No. 027; January 1991) Note: Repeal pending
10. Methods and Assumptions for Use in Life Insurance Company Financial Statements Prepared in Accordance with GAAP (Doc. No. 068; March 2000)

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ASB Appoints ERM Task Force

- ❑ 2005 – decided field was not yet ready
- ❑ 2010 – reported back with recommendations
 - Existing SOPs not sufficient to guide actuaries practicing in ERM area
 - ERM is significant new area of actuarial practice
 - Actuaries need standards in this new area
 - Regulators are moving towards ERM regulations where professional standards could be important

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Why we couldn't use the existing SOPs for ERM...

- ❑ Existing ASOPs are very specifically targeted, usually extremely limited in scope, and it is not easy to generalize from them
- ❑ All ASOPs apply to ERM, but they do not cover a significant part of ERM practice
- ❑ Many important ERM topics are not mentioned at all in ASOPs
- ❑ Many ASOPs are regulatory (or accounting) focused. Some ERM practices are becoming regulatory focused.
- ❑ Some risk management related issues are mentioned as totally optional practices and almost never is there any specific guidance
- ❑ Actuaries would tend to want to rely on some standard and might tend to use COSO or ISO standards that also do not address many actuarial issues
- ❑ ASOPs do not talk about true economic value
- ❑ Risk issues in liability determination are not addressed
- ❑ **Conclusion:** We need to develop one or, more likely, several new ASOPs relating to ERM

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Actuarial Standards Board (ASB)

- ❑ May 2010
 - Accepted Task Force recommendations
 - Requested Task Force to develop draft standards
- ❑ March 2011
 - Task Force presents draft ERM standards to ASB
 - Board decides to circulate the draft standards for comments

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Draft Standards

1. Risk Evaluation
 - Economic Capital Models
 - Other Risk Evaluation
2. Risk Treatment
 - Risk Control Cycle
 - ❑ Risk Tolerance/Appetite/Limits
 - ❑ *Risk measuring and reporting (Covered in above)*
 - ❑ Risk Mitigation
 - ❑ Emerging Risks

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Important ERM Topics that were not included

- ❑ Culture
- ❑ Organization
- ❑ Governance

New ORSA/IRMA requirements

- ❑ An opinion on the adequacy of the ERM system and the Capital of the firm
- ❑ Made by the [management and the board](#)
- ❑ Based upon their own assessment of company FUTURE plans and risks and capacity to bare risks

Key ERM elements in new IRMA/ORSA Requirements

- 1) Identify risks
- 2) Measure risks
- 3) Risk feedback loop
- 4) Risk tolerance statement
- 5) Risk policy

Key ERM elements in new IRMA/ORSA Requirements

- 1) Identify risks <==Specified
- 2) Measure risks <==Risk Evaluation
- 3) Risk feedback loop <==Risk Treatment
- 4) Risk tolerance statement <==Risk Treatment
- 5) Risk policy <==Risk Treatment

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Adequacy of Capital

- ▣ Addressed by Risk Evaluation

Preliminary Conclusion:

- ▣ These two standards would support an actuarial professional opinion for the ORSA/IRMA

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Contents of Draft ERM Standards

- ▣ Scope
 - Discussion of tasks performed
 - Tells when to apply standard
- ▣ Considerations (Shoulds)
- ▣ Communication
- ▣ Disclosures (Musts)

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Economic Capital Tasks (Examples)

- Design, build, operate and/or report on the findings of an organization's Economic Capital model.
- Review and validate the results of an organization's Economic Capital model.
- Develop, review or validate the assumptions and methodologies underlying an Economic Capital model.
- Provide an independent third party review of an organization's Economic Capital model.
- Provide documentation relating to an organization's Economic Capital model.
- Analyze the impact of a strategic decision on an organization's Economic Capital.
- Recommend allocations of Economic Capital to units with an organization.
- Communicate the purpose, use(s), results and limitations of an Economic Capital model to both technical and non-technical audiences.

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Economic Capital Considerations (Examples)

- The appropriateness of the selected time horizon and confidence level underlying an organization's definition of Economic Capital.
- The degree to which the Economic Capital model captures all material risks of the organization in a consistent manner.
- The degree to which the Economic Capital model is dynamic and flexible in nature, robust, reproducible and adaptable to new risks.
- The appropriateness of an Economic Capital modeling framework that doesn't allow for Stress Testing and Scenario Testing.

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Economic Capital Considerations

- The degree to which the Economic Capital models reflect the nature, scale and complexity of the organization.
- The degree to which the methodology and supporting assumptions underlying an Economic Capital model are identified, supported and documented.
- The quality, accuracy, appropriateness and completeness of data underlying an Economic Capital model.
- The appropriateness of manual data entry and duplication of effort versus automation.
- The appropriateness of the methodologies for Economic Capital model validation and calibration.

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Communication & Disclosures

- Model Results
- Model Limitations
- Expected usage
- Assumptions
- Whether reserve adequacy was considered
- Future Risk mitigation actions included
- Deviation from standard

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Questions posed in Request for Comments

- ❑ Does this conflict with any other standards for ERM of firms?
- ❑ Are these too prescriptive or too little prescriptions
- ❑ Do these cover the ERM work of actuaries?
- ❑ Could these be of help to actuaries if they are doing ERM work outside of insurance?
- ❑ Are they clear?
- ❑ Do they encourage the right behaviors and discourage the wrong behaviors?

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Future of these Drafts

- Comment Period through _____
 - Comments accepted from _____
- Task Force will prepare discussion of comments and review with ASB
 - There will be some public communication on that discussion

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Future of these Drafts

- If board agrees, Task Force will proceed to write standards
 - There will be a second comment period
 - At the end of the second comment period,
 - the board considers the comments,
 - agrees to changes (or not) and then
 - Makes the revised standard effective

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Conclusion

- Thanks to the ERM Task Force for their work over the past 15 months
[David Ingram](#), [Chairperson](#), [Mary Ellen Coggins](#), [Wayne Fisher](#), [Kevin Madigan](#), [Clause Metzner](#), [David Rogers](#), [Max Rudolph](#), [Dave Sandberg](#), [John Stark](#)
- Please Read the draft standards
- Consider the questions raised
- Consider making comments to the board

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Postscript

- There is a new movement in the International Actuarial Association to produce a set of International Actuarial Standards of Practice
 - Demand from smaller associations who would rather rely upon international standards than try to create their own
- The IAA has formed a committee to start to create a small set of standards
 - An ERM Task Force has been formed to create an ERM standard

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