

Compliance In a Principles-Based System

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Actuary

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Current Valuation Framework

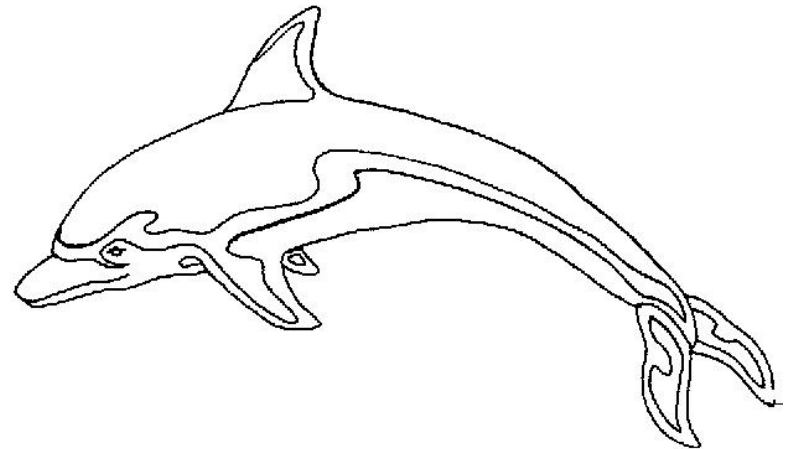
- Prescribed Formulas (CRVM, CARVM)
- Prescribed Mortality
- Prescribed Interest Rate
- Prescribed CSV Floor (Aggregate)
- Prescribed Actuarial Guidelines
- Prescribed Asset Adequacy Testing

Problems with the Current System

- Technologically outdated – virtually unchanged for almost 150 years
- Internationally non-competitive
- Statutory reserves are inappropriate
- Does not address all risks - innovative products present problems
- Industrial age thinking
- The dog is always chasing its tail

Quote of the Moment

- "Why does Sea World have a seafood restaurant? I'm halfway through my fishburger and I realize, Oh my God....I could be eating a slow learner."--Lynda Montgomery



Principle-Based Framework

- Process of Identifying All Risks
- Process of Determining PBE Assumptions
- Process of Determining Appropriate Margins
- Process of Modeling and Measuring Risks
- Process of Sensitivity Testing Material Risks
- Process of Documenting All Processes

Challenges of a Principles-Based System

- Law based on principles
- Inertia
- Regulation of adherence to principles
- Coordination with other issues (taxes)
- Training

Framework Differences

- Process vs. Prescription Orientation
- Stochastic (Chaos) vs. Deterministic (Formulas)
- All Risks vs. Prescribed Risks
- Company Expected vs. Industry Expected
- Aggregate vs. Seriatim
- Adequate vs. Minimum Reserve
- Audit of Process vs. Audit of Prescription

Quote of the Moment

"Today I met with a
subliminal advertising
executive for just a
second."

– Steven Wright



Audit Process

- Evaluation of Model and Model Dynamics
- Validation of Model Assumptions
- Evaluation of Margins
- Evaluation of Sensitivity Analysis
- Evaluation of Documentation
- Signoff of Acceptable Process

Validation of Model Assumptions

- Evaluate Company Experience Studies
- Evaluate Experience Data Credibility
- Review Investment Policy
- Review Hedging Strategy
- Evaluate anticipated experience assumptions based on Experience Data, Data Credibility and Company Policies and Strategies
- Evaluate anticipated experience assumptions where no Credible Data is available

Evaluation of Documentation

- Processes well Documented ?
- Risks well Documented ?
- Policies and Strategies well Documented ?
- Assumptions well Documented ?
- Margins well Documented ?
- Results and Sensitivity Analysis well Documented ?

Regulatory Signoff

- Regulatory Report Issued
- Acceptable Process Completed
- Statement of Compliance with Law / Regulation

Motto of the Society of Actuaries

“The work of science is to substitute facts for appearances and demonstrations for impressions.”

- Ruskin

Translation ...

“Actuaries lend reason to what would otherwise be a passionate life”

- Randall Stevenson