

Discussing Actuarial Standards of Practice for ERM

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Sept 2012

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 - Member, ERM Task Force of the Actuarial Standards Board
 - Member, Two ERM committees of the AAA
- **David Sandberg**
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 - President, American Academy of Actuaries
 - Member, ERM Task Force of the Actuarial Standards Board

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Agenda

Kevin will discuss a little history and provide some context and then Dave will lead an interactive discussion.

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Draft Actuarial Standard of Practice

Risk Evaluation in Enterprise Risk Management

Released for Comment April, 2012
Comment period ended June, 2012

Risk Treatment in Enterprise Risk Management

Released for Comment June, 2012
Comment period ends Sept 10, 2012

ERM Task Force of the ASB

David Ingram, Chairperson, Maryellen Coggins, Eugene Connell, Wayne Fisher, Kevin Madigan, Clause Metzner, David Rogers, Max Rudolph, Dave Sandberg, John Stark

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Actuarial Standards of Practice

- ❖ Standards & Code of Conduct are true signs of a profession
- ❖ Defines what can be considered true actuarial professional work
 - ❖ Code of Conduct addresses expected Professional Behavior Expectations of the individual actuary
 - ❖ Standards address work of the individual actuary

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Actuarial Standards of Practice

- ❖ Provide Guidance to Actuaries and Employers of Actuaries
- ❖ 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
- ❖ Basis for Disciplinary Process

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ERM is Actuarial Work And is Already Covered by SOPs

Code of Conduct: Standards of Practice

- **PRECEPT 3.** An Actuary shall ensure that Actuarial Services performed by or under the direction of the Actuary satisfy applicable standards of practice.
- **ANNOTATION 3-3.** When an Actuary uses procedures that depart materially from those set forth in an applicable standard of practice, the Actuary must be prepared to justify the use of such procedures.

Introduction to Standards of Practice

- 3.1.6 The ASB recognizes that actuarial practice involves the identification, measurement, and management of contingent future events in environments that rarely, if ever, emerge exactly as projected.

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Standards that Apply to ERM Work

- 7. Analysis of Life, Health or Property Casualty Cash Flows
- 23. Data Quality
- 38. Using Models Outside The Actuary's Area of Expertise (Property and Casualty)
- 41. Actuarial Communications

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ASB Appoints ERM Task Force

- ❖ 2005 – decided field was not yet ready
- ❖ 2010 – reported back with recommendation to create ERM SOP
- ❖ 2011 – Exposed Discussion Drafts on Risk Evaluation and Risk Treatment
 - Spent the last half of 2011 revising and reacting to comments
- ❖ 2012 – Presented proposed SOP on Risk Evaluation and Risk Treatment to ASB
 - April - Released Risk Evaluation Exposure Draft, Comment Period Closed
 - June – Released Risk Treatment Exposure Draft, Comment Period Open

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Important ERM Topics that were not included

- ❖ Culture
- ❖ Organization
- ❖ Governance

These will be considered at a later date.

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Own Risk and Solvency Assessment (ORSA) – a global trend in insurance supervision

- In late 2011, the NAIC preliminarily adopted a US Own Risk and Solvency Assessment (ORSA) requirement. ORSA requirements are also being introduced in many other territories, including Europe, Bermuda and Canada. In general, these are consistent with one another.
- The IMF assesses financial supervisory regimes against a common set of international core principles, one of which contains an ORSA requirement.
- The next IMF review of the US is scheduled for 2014; the NAIC expects to implement the ORSA requirement in advance of that review

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Own Risk and Solvency Assessment (ORSA)

"An insurer...will be expected to regularly conduct an ORSA to assess the adequacy of its risk management and current, and likely future, solvency position, internally document the process and results, and provide a high-level summary report annually to the domiciliary regulator, if requested"
- NAIC Own Risk and Solvency Assessment (ORSA) Guidance Manual

- The ORSA Guidance Manual was adopted in November 2011 after a period of intense industry comment and engagement
- A pilot exercise was run in June 2012, from which the NAIC plans to issue public feedback on a no-names basis – Telling Comment from Regulator at Aug. NAIC meeting – The ORSA will be a game changer
- Model Law currently being drafted – an exposure draft has been released
- The NAIC's guidance exempts those with annual premium of less than \$500M at the company level or \$1Bn at the group level

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Regulators expect the US ORSA to play a significant role in US insurance supervision

"The ORSA Summary Report may help determine the scope, depth and minimum timing of risk-focused analysis and examination procedures...Insurers with ERM frameworks deemed to be robust for their relative risk may not require the same scope or depth of review, or minimum timing for a risk-focused surveillance as those with less robust ERM functions."
NAIC Own Risk and Solvency Assessment (ORSA) Guidance Manual

- **Risk management** – The ORSA will be a tool to help supervisors understand the risks insurers are exposed to, and how adept insurers are at managing those risks. Regulators plan to assess ERM capability, and to use it to guide their supervisory strategy
- **Group capital assessment** – Examiners and NAIC analysts will use the ORSA to assess groups' own assessment and management of their capital at group level. While the ORSA will not set a group capital requirement, it will provide information to regulators that will help guide supervisory action
- **Encouraging ERM** – The NAIC expects the ORSA to help foster effective ERM practices at all insurers

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The ORSA guidance manual requires a 3-section structure for the ORSA summary report

Section 1 – Description of the insurer's risk management framework

- Summary of the risk management framework and policies; appropriate to the nature, scale, and complexity of company's risks

Section 2 – Insurer's assessment of risk exposures

- Management's quantitative and/or qualitative assessment of risk exposures in normal and stressed environments

- Should reflect how business is managed in practice

Section 3 – Group risk capital and prospective solvency assessment

- Discuss how risk assessment is used to determine required financial resources - under both normal and stressed conditions

- Demonstrate sufficient capital to execute multi-year business plan, even under adverse scenarios

- Should detail management actions taken (or to be taken) if inadequate capital

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ERM Standards mean that actuaries expect to perform their work with a full review of the context in mind.

The actuarial profession is taking the important first step in the process of creating ERM standards of practice.

- The process of getting to great ERM standards is similar to the process of getting to a great ERM system for a company
- Taking a first step is even more important than exactly what that first step is.

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Quick Overview of an ERM System

Risk Control Cycles

- Enterprise Level
- Risk / Business Unit Level

Management Systems

- CRO, Risk Committee
- Risk Owners
- Engagement with
 - entire organization
 - Board of Directors

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Elements of Risk Control Cycle

- Identify Risks
- Assess Starting point
 - Evaluate retained risks from prior activities
 - Evaluate capacity to survive losses
- Evaluate Plans
 - Risk Acceptance
 - Risk Treatment
 - Expected Return, volatility, extreme loss potential and correlation with other plans
- Choose types and amounts of risks
- Implement Plans
- Monitor
- Adapt to variations from plan
- Report on Results and Restart Cycle

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- Identify Risks
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- Choose types and amounts of risks
- Implement Plans
- Monitor (**Evaluate** positions and report)
- Adapt to variations from plan
- Report on Results (**Evaluate**) and Restart Cycle

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Postscripts

- There is a desire at 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 consider an ERM standard
 - A Statement of Intent will be proposed to the Executive Committee and is in process of preparation
 - Expected/possible timing = 2 – 4 years

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Postscripts

- Risk Managers in Banking Practice
- RIMS
- Regulators – ORSA, Treasury, IAIS

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Discussion Points

- Is ERM a foundational topic or just one floor of many on the actuarial range of practices from life to pensions to health to auto insurance, etc.?

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Discussion Points

- What is the perceived value and direction of ERM for the profession?
 - Evaluation of Identified Risk?
 - Overseeing a process for both quantifiable and non-quantifiable risk with focus on “What’s Missing?”

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Discussion Points

- Should there be additional ASOPs?
- If so, which ones?

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Discussion Points

- Will new ASOPs enhance or limit the use of actuaries?

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