AMERICAN ACADEMY *of* ACTUARIES

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June 17, 2015

Chairman Jeb Hensarling
House Financial Services Committee
2129 Rayburn House Office Building
Washington, DC 20515

Ranking Member Maxine Waters
House Financial Services Committee
4340 Thomas P. O'Neill, Jr.
Federal Office Building
Washington, DC 20515

Dear Chairman Hensarling and Ranking Member Waters,

On behalf of the American Academy of Actuaries[1] Financial Regulatory Task Force, I appreciate this opportunity to offer our feedback on the 2015 Annual Report of the Financial Stability Oversight Council (FSOC) for the House Financial Services Committee hearing titled "The Annual Report on the Financial Stability Oversight Council."

When the annual report was released last month, we were disappointed to see that it overlooked the contributions of actuarial professionalism to U.S. financial stability. There was only a single mention of the actuarial standards of practice and actuarial guidelines (in relation to the National Association of Insurance Commissioner's (NAIC) Actuarial Guideline 48, *Actuarial Opinion and Memorandum Requirements for the Reinsurance of Policies Required to be Valued under Sections 6 and 7 of the NAIC Valuation of Life Insurance Policies Model Regulation, Model 830*). However, the U.S. actuarial profession's work in developing and supporting the public interest goals of effective financial systems go far beyond collaborating with the NAIC, state legislators, and regulators to develop guidelines for responsible risk management practices and solutions in U.S. markets.

The actuarial profession fills a key role in ensuring the solvency and stability of U.S. domestic financial systems and contributes to to the formulation of international insurance and retirement system public policy. Through its professionalism and strong focus on the measurement and management of risk, the profession supports sound financial and insurance systems that help individuals and businesses protect themselves against uncertain future events and ensure their financial security. Resilient and sustainable systems contribute to the public interest by providing robust private market mechanisms so that public social safety net systems are not overburdened.

[1] The American Academy of Actuaries is an 18,500+ member professional association whose mission is to serve the public and the U.S. actuarial profession. The Academy assists public policymakers on all levels by providing leadership, objective expertise, and actuarial advice on risk and financial security issues. The Academy also sets qualification, practice, and professionalism standards for actuaries in the United States.

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Actuaries' education, experience, and adherence to professional standards uniquely qualify them to offer objective feedback on the actuarial soundness of laws, regulations, guidance, and other proposals to policymakers. To support these efforts, the profession has developed numerous Actuarial Standards of Practice (ASOPs)—practice notes that provide best practices on issues of actuarial concern, and other resources.

The Academy is committed to helping regulators and legislators improve U.S. financial stability. I strongly urge the Committee to encourage the FSOC to include an overview on recent actuarial ASOPs, practice notes, and other materials, similar to what is already done for accounting standards, in its next annual report. To help the Committee understand the important contributions the U.S. actuarial profession makes to financial and insurance regulatory systems, I have attached a copy of the task force's 2014 overview on actuarial standards and guidelines we prepared for the FSOC, which has been updated to include a discussion draft on Capital Adequacy Assessments released by the Actuarial Standards Board last month. The overview specifically discusses our perspectives on recent changes to actuarial standards and guidance in the areas of professionalism, enterprise risk management, solvency, and pensions.

If you have any questions about this overview or would like to discuss these issues in more detail, please contact Lauren Sarper, the American Academy of Actuaries' senior policy analyst for Risk Management and Financial Reporting, at 202-223-8196 or sarper@actuary.org.

Sincerely,

Jeffrey S. Schlinsog, MAAA, FSA
Chairperson, Financial Regulatory Task Force
Risk Management and Financial Reporting Council
American Academy of Actuaries

Actuaries and Financial Stability

The actuarial profession plays a prominent role in protecting the solvency and stability of domestic and international financial systems because of its strong focus on the measurement and management of risk and its history of contributing to sound insurance systems, regulatory frameworks, and compliance mechanisms. These systems, in turn, protect individuals and businesses in the face of uncertainty and catastrophic events.

Qualifications

Actuaries have the skills necessary to assist U.S. policymakers in protecting financial stability because of their unique qualifications from extensive education, experience, and professional standards. Actuaries must take a series of examinations on a range of insurance, financial, and risk-related topics to obtain their primary credential. The examinations cover basic actuarial concepts on interest theory, contingencies, investments basics, as well as specialized tracks on different lines of insurance, enterprise risk management (ERM), investments, and retirement benefits. Actuaries tend to specialize in certain functions—such as valuation, pricing, model creation, risk-based capital, financial reporting, audit functions, etc.— and earn targeted continuing education on emerging risks, evolving assessment techniques, and changes in regulations. They typically focus in a specific area of practice: life insurance, property and casualty insurance, health insurance, or pensions. As a result, they are experts in recognizing and analyzing risk and modeling financial security programs, which allows them to provide vital feedback on the feasibility of legislation, regulations, and guidance under consideration.

Professionalism

The U.S.-based actuarial organizations[2] provide valuable resources to actuaries in their pursuits to maintain insurer and retirement system solvency and encourage general financial stability. These groups research and develop new models to protect solvency and recommend new mechanisms to streamline financial reporting. They identify inconsistencies and recommend changes to current rules and regulations to ensure consistency in the calculation and reporting processes. The groups offer continuing education to help actuaries fulfill actuarial standards and requirements.

The profession maintains strong processes that serve the public interest and keep actuaries professionally accountable. The five U.S. -based actuarial organizations, including the American Academy of Actuaries (the "Academy"), have all adopted the Code of Professional Conduct (Code). Compliance with the Code requires members of those organizations to adhere to actuarial standards of practice (ASOPs) promulgated by the Actuarial Standards Board (ASB) and the Qualification Standards for Actuaries Issuing Statements of Actuarial Opinion in the United States (USQS) promulgated by the Academy's Committee on Qualifications (COQ).

The Code identifies the professional and ethical standards required of actuaries who belong to the relevant organizations. It sets forth what it means for an actuary to act as a professional. It identifies the responsibilities that actuaries have to their clients, employers, and to the actuarial profession. The Actuarial Board for Counseling and Discipline (ABCD) is responsible for considering

[2] The American Academy of Actuaries, the American Society of Pension Professionals and Actuaries, the Casualty Actuarial Society, the Conference of Consulting Actuaries, and the Society of Actuaries.

complaints alleging violations of the Code. An important element of the discipline process is Precept 13 of the Code. Precept 13 requires an actuary with knowledge of an apparent, unresolved, material violation of the Code by another Actuary to attempt to resolve the apparent violation or to disclose such violation to the ABCD. When the ABCD determines an actuary has materially violated the Code, it recommends discipline action be taken by the appropriate actuarial organization. Public discipline of Academy members is available on the Academy's website.

As part of their work, some actuaries prepare Statements of Actuarial Opinion (SAOs) for insurers in order to comply with the National Association of Insurance Commissioner's (NAIC) annual statement instructions or other regulatory requirements. While ASOPs may be used to provide guidance on the preparation of the SAOs, the USQS specify requirements for basic education, experience, and continuing education that must be met by actuaries issuing SAOs. The details of each actuarial line of work—health, property and casualty, life, risk management, pensions, etc.—are varied and may require actuaries with a very specific set of skills and education when issuing an SAO.

The ASB establishes and improves the ASOPs. The ASOPs identify what the actuary should consider, document, and disclose when performing an actuarial assignment. The ASB's goal is to set standards for appropriate practice in the U.S.

Resources

Their professionalism makes actuaries a knowledgeable and valuable resource to regulators and policymakers as they develop laws, regulations, and rules for the insurance and retirement industries. Regulators and legislators have long recognized the vital role actuaries play in maintaining insurer solvency. Almost 30 years ago, the regulations governing insurance valuation were changed to require a formal opinion from an Appointed Actuary regarding the adequacy of insurance reserves, in accordance with professional standards.

Today, actuaries continue to occupy an important role in the regulation of insurance. They provide Appointed Actuary Opinions on the adequacy of insurers' reserves, and help prepare insurers' Own Risk and Solvency Assessments for regulator review. They also help the NAIC develop, in addition to important model laws and regulations, Actuarial Guidelines (AG) that are intended as guidance for applying specific state laws to certain actuarial circumstances. Health and pension actuaries also provide resources and recommendations to the federal government in non-insurance areas.

Recent Updates to Actuarial Standards and Guidelines

Professionalism

In December 2013, ASOP 25-*Credibility Procedures* was expanded by the ASB to cover pensions and life insurance practices beyond group term. The standard was previously limited to accident and health, group term life, and property/casualty coverages. The standard became effective on or after May 1, 2014.

The ASB is currently working on a revision for ASOP 38- *Using Models Outside The Actuary's Area of Expertise (Property and Casualty)* and is examining a potential new modeling standard that would apply to a wide variety of models. Information on recent changes to other ASOPs not discussed in this document is contained in Appendix A.

Last year, the Academy issued an infographic to assist actuaries in better understanding the applicability of the USQS and the related continuing education (CE) requirements Currently, the Academy is working to finalize an attestation form which can help regulators and actuaries document compliance with the USQS generally and demonstrate when the standards are satisfied in order to be a "qualified" actuary in a specific area of practice.

Enterprise Risk Management/Own Risk and Solvency Assessment

In May 2015, the ASB released a discussion draft on Capital Adequacy Assessments for Insurers. The document is intended to help develop additional guidance for actuaries preparing an assessment of capital adequacy, whether for a specific regulatory requirement or for general management purposes.

In July 2013, the Academy developed a practice note on Insurance Enterprise Risk Management to explain emerging regulatory guidance and emerging practices in the field. In September 2014, the Academy published an overview of the potential role of the actuary within an Own Risk and Solvency Assessment (ORSA) [3] process.

The ASB developed two new ASOPs for actuaries working in the ERM field in late 2012: ASOP No. 46 - Risk Evaluation in Enterprise Risk Management and ASOP No. 47 - Risk Treatment in Enterprise Risk Management. The ASB is also developing a standard to address the implementation of ORSA.

In October 2014, the Joint Risk Management Section[4] released the e-book "How to Review an ORSA." The e-book combines several articles that provide an overview for companies of how to put together an ORSA report and for regulators on how to effectively review an ORSA report.

[3] As defined by the NAIC, an ORSA is an internal process undertaken by an insurer to assess the adequacy of its risk management and solvency positions under normal and severe stress scenarios. An ORSA requires insurers to analyze material risks (i.e., underwriting, credit, market, operational, liquidity risks, etc.) that could have an impact on an insurer's ability to meet its policyholder obligations "Own Risk and Solvency Assessment (ORSA)," *CIPR Topics*, NAIC, August 14, 2014.
[4] Made up of the Canadian Institute of Actuaries[4], Casualty Actuarial Society, and Society of Actuaries.

Finally, the profession created the Chartered Enterprise Risk Analyst (CERA) credential. It certifies the actuaries are qualified to work on ERM related reports and issues. This certification was established under an international treaty in 2009 and is now available worldwide.

Solvency

Currently, the Academy is working with the NAIC and other regulators to develop and refine aspects of the U.S. risk based capital (RBC) formula and the Standard Valuation Law and the associated technical Valuation Manual (VM) for life insurers. In June 2014, the Academy provided a report to the NAIC on the "Recommended Approach for Updating Regulatory Risk-Based Capital Requirements for Interest Rate Risk for Fixed Annuities and Single Premium Life Insurance." The report proposed the use of consistent methodologies among the different interest rate risks for life insurance products to more accurately reflect a life insurer's exposure to risks in the RBC formula. In February 2014, the Academy issued "Exposure Draft of Practice Note on Life Principle-Based Reserves Under VM-20". This practice note provides advice on calculating minimum valuation statutory reserves for life products outlined in the Valuation Manual.

In response to international efforts to create a global capital standard, the Academy provided feedback to U.S. policymakers on appropriate group solvency and capital standards. The Academy's Solvency Committee developed ten principles that must be considered during the development process, including: clearly defining the regulatory purpose and goals; promoting responsible risk management in the regulated group and encouraging risk-based regulation; and focusing on the total asset requirement rather than the required reserves or capital.

Pensions

In December 2013, the ASB revised ASOP 4, *Measuring Pension Obligations and Determining Pension Plan Costs or Contributions*. The ASOP requires new disclosures concerning the funded status of a pension plan, disclosure of the rationale for changes in cost or contributions, and new disclosures regarding the implications of the contribution allocation procedure or the plan sponsor's funding policy. It is effective December 31, 2014.

In September 2013, the ASB updated ASOP 27, *Selection of Economic Assumptions for Measuring Pension Obligations*. The revision: clarifies that economic assumptions can be based on either the actuary's best estimate or estimates inherent in market data; uses reasonable assumptions instead of a "best estimate range;" requires the disclosure of the rationale used in selecting assumptions; and distinguishes between prescribed assumptions or methods set by law versus set by another party. The standard became effective September 30, 2014. The ASB is also working on a standard that would help actuaries assess and describe risk inherent in pensions.

The Academy has launched *Retirement for the AGES*, which introduces principles necessary to examine retirement plans and policy proposals, including ensuring that a given retirement system is able to weather the financial recessions and inflation.

The Conference of Consulting Actuaries recently published *Actuarial Funding Policies and Practices for Public Pension Plans* to provide information to policymakers and other interested parties on the development of actuarially based funding policies for public pension plans.

Appendix A

Other Recent Changes to the ASOPs

In May 2014, ASOP 6-*Measuring Retiree Group Benefits Obligations and Determining Retiree Group Benefits Program Periodic Costs or Actuarially Determined Contributions* was updated to create new disclosure requirements for funded status and contributions, changes in assumptions and methods and allocation procedures, and assumption rationale, to provide guidance in setting trend rates and selecting of acceptance, lapse, and re-enrollment rates, and improve coordination with ASOP 4-*Measuring Pension Obligations and Determining Pension Plan Costs or Contributions*. The changes are effective for any public actuarial work product with a measurement date on or after March 31, 2015.

In March 2014, the ASB revised ASOP 8-*Regulatory Filings for Health Benefits, Accident and Health Insurance, and Entities Providing Health Benefits* to reflect changes in regulatory health filings because of statutory and regulatory changes from the Affordable Care Act. The changes became effective for any actuarial work product covered by the standard's scope on or after September 1, 2014.

In December 2013, ASOP 48-*Life Settlements Mortality* was changed to update the guidance for mean life expectancy, median life expectancy, the mortality assumption, and disclosure practices. This was done in order to improve the development and evaluation of mortality assumptions and mortality experience associated with life settlements. The changes became effective for any actuarial work product covered by the standard's scope on or after April 30, 2014.

Finally, the ASB introduced a new ASOP in March 2013: ASOP 1-*Introductory Actuarial Standard of Practice*. ASOP 1 makes clear that the ASB, in promulgating ASOPs, seeks to define an appropriate level of practice (rather than simply codifying current practices.

More information on all 48 ASOPs may be found here:
http://www.actuarialstandardsboard.org/asops.asp