

The Actuarial Profession
making financial sense of the future

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Use-ful or Use-test?

Use test working party findings

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Introduction

- Use test?
- Effective basis for decision making?
- **BOTH?!**

We will discuss:

- The requirements of the Use test
- Possible interpretations (use-ful or use-test?)
- Practical next steps

The Use Test – what’s it all about?

“Letter ” of the Use-Test:

“The undertaking’s use of the internal model shall be sufficiently material to result in pressure to improve the quality of the internal model.”

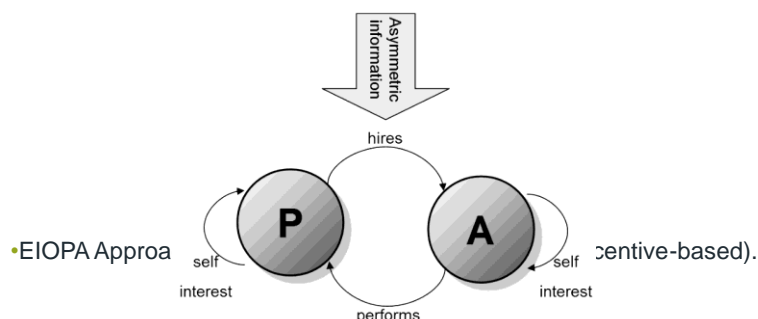
“Spirit” of the Use-Test:

- Aligning interests;
- Preventing “gaming of the system”, paying “lip service”;
- Ensuring faith in the numbers;
- Continuous investment.

The Use Test – what’s it all about?

A Familiar Context: Theory of Incentives

- Principal-Agent Problem and Asymmetric Information.
- e.g. Delegated Underwriting Authorities, Reinsurance Submissions



The Use Test – from the regulator’s viewpoint

- Which means that:
 1. Focus is on the 1-in-200: “Use” should enhance the confidence in the regulatory capital derived
 2. Focus is on the numbers, not the platform: “Use” may be decoupled from using the DFA platform itself
 3. “Use-Test” does not necessarily imply Usefulness to the business
- In the background it also sends “signals” about the company’s risk management.

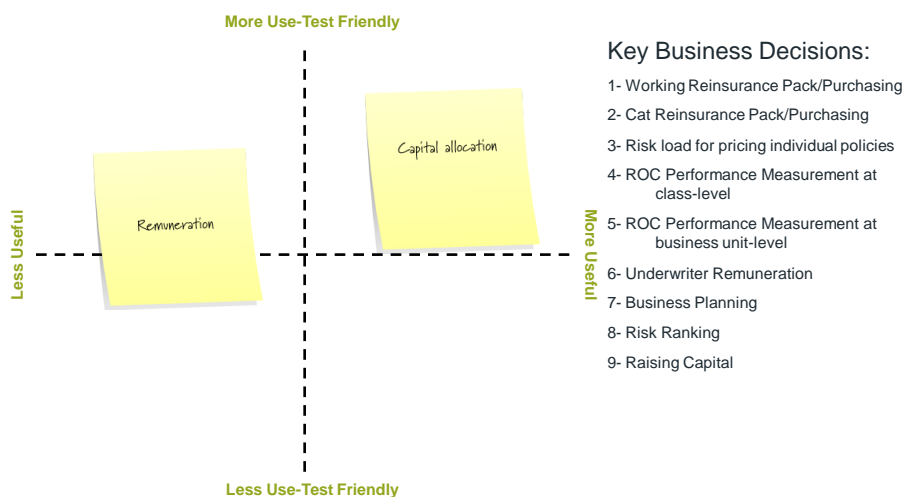
The Use Test – from the company’s viewpoint

- Which means that:
 1. Range of return periods: E.g. 1 in 5 is more useful, to understand short to mid - term volatilities in the financials
 2. Complexity vs usability: Simplifying approximations/ faster run times would make the model more “useful
 3. Mapping existing/planned uses of the model that the business is bought into is better than “creating” uses to fit the requirements
- The more the model gets used and challenged the better it gets

Use-Test Vs. Use-ful – examples of Use

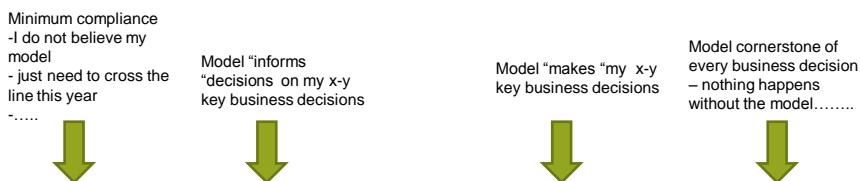


Use-Test Vs. Use-ful – let's talk



Use-Test Vs. Use-ful

- Where should you sit on the scale?



Next steps

Possible plan to implementation

- Workshop to determine:
 - What might be useful and where are the information gaps?
 - What might be possible?
 - Any areas where validation needs to be strengthened?
- Feasibility study
 - Focus on small number of big wins
 - Test MI ideas on relevant parties
- Plan the "Solvency II feedback loop"
 - Make sure you are addressing specifics of "Use test"
- Implement

Conclusions/wrap up
