



The Actuarial Profession

making financial sense of the future

consultation response

**Board for Actuarial Standards –
Technical Actuarial Standard – Modelling (TAS M)**

Comments from the Actuarial Profession

September 2009

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Reference: IP/KC/TAS-D Consult

Dear Louise

Technical Actuarial Standard - Modelling (TAS M)

The Profession welcomes the opportunity to respond to the exposure draft of TAS M.

We are generally supportive of the revised TAS and note that helpful changes have been made as a result of the initial consultation. However our reservations are somewhat similar to TAS D and we are surprised and concerned that BAS wish to bring all three¹ generic TASs into effect as mandatory standards at the same time from 1 April 2010.

Summary of our Response

1. We welcome the changes to TAS-M and support the thrust of the Standard. However we believe that, unless there is clarity on what is meant by proportionality, the Standard will not have the impact which the BAS intend.
2. We suggest that some of the Principles are amplified to illustrate what the BAS consider to be a proportionate approach. Some drafting points for consideration have been included in our response which may help in this regard. In addition consideration could be given to using C8.1 (particularly in the area of identifying the limitations of the model) to help drive proportionality.

¹ i.e. the Reporting, Data and Modelling TASs.

3. Given there are unknown unknowns, Principle C8.1 should only require those limitations which are **reasonably foreseeable** to be explained.
4. The requirement to apply TAS M to Aggregate Reports completed after the Commencement Date imposes significant time, resource and cost on Clients and Entities due to the inevitable backtracking involved. Hence we believe transition arrangements are required to substantially mitigate this.
5. As covered in our response to TAS R, we believe that the Standard should focus on the Primary Users and that by widening the definition to include other interested parties, the impact of the Standard will be diluted. If BAS wish to set standards to determine what should be available to other parties, their requirements should be separately identified.
6. Consideration should also be given to Solvency II requirements to avoid the potential for UK Insurers to be disadvantaged compared with Insurers in other EU member states.

The above points are amplified below.

1. Clarifying proportionality and raising awareness of the application of the Principles.

We believe there are clear benefits to raising awareness of the application of the Principles for all TASs¹. This will increase understanding and enable the application of the Principles to be applied in a proportionate way, as intended by BAS, whilst simultaneously promoting the positive aspects of the Standard. We believe it should be more obvious from the Standard when current best practice complies and when greater rigour is required.

For example, your background paper, produced prior to the first consultation for TAS M, pointed out that good models enable important decisions to be based on sound information, but they all have limitations, given they cannot reflect reality in all its complexity.

This is encapsulated in one of the most important Principles in the TAS (in C8.1), which requires Users to be advised of

- a) the implications of the material limitations of the model and
- b) the extent to which the model meets the User's needs (which requires the purpose to be clear)

We have two points to make on this Principle:-

- Firstly, given there are unknown unknowns, we think the Principle should require explanation of 'the implications of material **and reasonably foreseeable** limitations of the model'. Clearly this would be reassessed from time to time.
- Secondly, we suggest that C8.1 could be used to classify the 'limitation profile' of a model. Low limitation models (for example those which are well tried and trusted) are more likely to comply with the Standard, whilst high limitation models exhibiting certain other characteristics² would demand more rigour. This initial thinking may then help with the application of the Proportionality Principle.

2. Proposed Commencement Date of 1 April 2010

We now turn to your invitation to comment on the proposed Commencement Date.

As covered in our response to TAS D, we consider it is disproportionate for the TAS to apply to Aggregate Reports completed after 1 April 2010. This would be acceptable if all the work relating to the Aggregate Report is carried out after the proposed Commencement Date. However Aggregate Reports may include work carried out many months ago (and even years ago where earlier projects are relied upon). Hence we think time, cost and effort should not be spent backtracking.

To illustrate the problem, consider the typical situation of preparing a consolidated report for the Group Board for a number of Insurance Companies. For each one of these Life Companies, a number of models will be used to produce results. Typically 10 to 15 models, with literally hundreds of spread sheets with many thousands of code lines will have been deployed. Consequently many person months of work will have been spent on producing an experience analysis to assist in recommendations to the Board. It would not be proportionate to require any form of backtracking in respect of this work.

We also note that that the requirement to state whether or not there has been compliance with TAS M in the six month period prior to 1 April (with earlier adoption prior to that being

² Models may be classified as high limitation models if they include any one of:- significant limitations, break new ground, apply to areas which are less understood, exhibit characteristics which implies there are significant unknowns etc.

encouraged) is optimistic (particularly as TAS M has not yet been published) and will merely result in statements of non compliance.

We believe that there should be an appropriate transition to the new TAS M and that consideration is also given to changing the Commencement Date itself to, for example, 1 May, given the concentration of work around 31 March and 1 April for Pension Fund Valuations, Life Company Reporting, and Statement of Opinions for Lloyd's Syndicates. Some consideration should also be given to the fact that Friendly Societies tend to report in June, so perhaps a later date could apply to them.

3. Impact of TAS M and Cost Benefit analysis.

You have invited comment on the impact of TAS M and on your cost benefit analysis.

3.1 Impact of TAS M

As stated above unless the application of the Proportionality Principle is explained, we believe the impact of TAS M will not be as the BAS intend.

We have noted the following largely drafting points which, if addressed, may introduce greater proportionality:-

- a) Paragraph 2.33 states that the documentation of all judgements is not now intended. However, C4.1 requires 'documentation to contain enough detail to assess the judgements made'
- b) C4.1 requires the documentation to be detailed enough for a technically competent person with no previous knowledge to understand the matters involved. However should these requirements apply only to the Actuary's team and possibly a Peer Reviewer?
- c) C6.1 (the effect of grouping), C6.4 (removal of outliers), C6.18 (the influence of the model on estimates - either assumptions or derived from outputs) appear more like Rules than Principles and could require excessive detail to be presented to Users. We believe they should be drafted more widely for example, to permit judgement to be exercised to determine what should be reported to Users.

3.2 Cost Benefit Analysis

We note your qualitative statement but think that a quantitative assessment should be made particularly if it is decided to apply the TAS to any work carried out before the Commencement Date. We suggest some case studies are prepared to help quantify the additional costs which can then be judged against the benefits.

It also appears from the information provided that input has been mainly from technical experts and it may be that greater input from Users is required to assist in this analysis.

We also believe it is important to consider if UK Insurers might be disadvantage compared with Insurers in other EU member states who will be subject to Solvency II requirements, rather than BAS Standards.

4. Definition of Users

Finally we note that the definition of Users is unchanged from TAS R. In our response to TAS R we covered why we believe that the Standard should focus on the Primary Users. We understand that due regard must be given to other interested parties in certain circumstances and believe that if this is to be covered by the Standard then, then their explicit requirements should be identified. We believe the impact of the TASs will be diluted if this is not addressed.

We hope the above is helpful and look forward to supporting you in the introduction of TAS M.

Yours sincerely

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on behalf of the Actuarial Profession

Please reply to the Faculty, Edinburgh