

Comment #4 – 12/21/11- 9:57 a.m.

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ASOP No. 38 Revision
Actuarial Standards Board
1850 M Street, Suite 300
Washington, DC 20036

RE: Proposed Revision of Actuarial Standard of Practice No. 38

I have the following comments on this ASOP 38 exposure draft:

OVERALL

I see two major issues with the ASOP.

First, it creates a contradictory standard in that it requires actions and judgments that normally are only reliable for someone with expertise in a subject, yet the scope is for those using models outside their area of expertise. Hence it places an onus on the actuary to make judgments that are outside their qualifications. It raises the issue of which is primary in the Code of Conduct, Precept 2 (Qualification Standards) or Precept 3 (Standards of Practice).

Second, it appears that the drafters were focusing solely on models of the loss process, such as hurricane and earthquake catastrophe models, and were not considering the use of financial market risk models by those involved in risk management (i.e., economic scenario generators). I suspect that such an alternative perspective would have resulted in a different standard, more realistic about relying on outside expertise in areas atypical for casualty actuaries. Specifically, I believe that the model should allow an actuary to use some outside models based solely on outside party reviews and explicit disclosure of that reliance.

DETAILED COMMENTS

1. Paragraph 3.1.b (personal review or reliance on another actuary's personal review).

This paragraph requires an actuary to either personally review a model or rely on another actuary's personal review of the model. My concern here is with the second option – relying on another actuary's review – I will address concerns with the first option in my comments on Section 3.2 and 3.3.

I don't see why the use of another party's review can only occur if the other party is an actuary. If the model involves subject matter outside the actuary's expertise, there is a chance that it requires subject matter expertise that is rare for any actuary. Why restrict

the range of possible reviews/reviewers to be relied upon? This shows a near paranoia about relying on those outside the actuarial world, but isn't that a key aspect of this standard, and a key reason why it was needed?

I recommend that ASOP 38 allow the reliance on outside reviewers, including non-actuaries. For example, when I buy a TV for my entertainment system I do not expect to become an expert in electronics and signal processing. Instead I learn how to read reviews of those that do have such expertise. I don't require them to be suburbanites, actuaries, or heterosexual white males (even though I fit into those categories). I rely on them to know their stuff, and to have communicated their review in an understandable, relevant form for a non-expert. (*Note: This discussion is repeated to some extent in the Paragraph 3.4 comment below.*)

2. Paragraph 3.2.1.a. – list of items requiring the subject actuary's review.

This paragraph requires the subject actuary, in their required personal review of the model, to “*consider the ... data, assumptions, parameters, or subjective judgments that affect the output of the model.*” If the model “*incorporate[s] specialized knowledge outside of the actuary's expertise*” then on what basis should they be applying their actuarial judgment of the model's internal assumptions? I would view such a practice as clearly violating Precept 2 of the Code of Conduct. I recommend that this paragraph be rewritten or deleted to be consistent with ASOP 38's scope and Precept 2 of the Code.

3. Paragraph 3.2.2 – required familiarity with model revisions

This paragraph requires the actuary to be “reasonably familiar” with significant revisions of the model incorporating knowledge outside their expertise, if the revisions were subsequent to the review for appropriateness. I agree that ASOP 38 needs to focus on the use of the version of the model that will be used, and not later or previous versions, but this wording requires the actuary to rely on those areas where the actuary is least qualified (per the wording of ASOP 38's scope). The actuary should not be required to apply professional judgment if the subject of the revision is outside their expertise. This is another situation where the standard is creating a Precept 2 vs. Precept 3 conflict. This familiarity with revisions should only enter into the considerations where the revisions are within the actuary's expertise. Otherwise, additional guidance is needed.

Should the ASOP include cautionary language here about the use of new model versions that have yet to be sufficiently tested/reviewed?

4. Paragraph 3.2.3 - Developments in Relevant Fields

Similar to the above comments, this paragraph requires an actuary to practice in areas where they are not qualified. If the model relies on knowledge outside the subject actuary's area of expertise, wouldn't new developments in that area also be outside their area of expertise? Rather than requiring the actuary to evaluate these developments, shouldn't the actuary instead be directed to subject matter experts for those experts' reviews/evaluations of these developments. The actuary may then be directed to use those outside reviews/evaluations in determining whether the outside model is still

appropriate for the intended use (assuming they are qualified to do so given those outside evaluations)?

5. Paragraph 3.3.1 - Model Components

This paragraph again requires an actuary to be reasonably familiar with details in areas outside their area of expertise. Note that the focus of the guidance was strictly on loss models. There was no mention of economic scenario generators (which require an entirely different set of components than utilized as examples in this paragraph). I believe that this paragraph is requiring a “familiarity” that is unnecessary as long as the extent of the reliance is explicitly disclosed in the actuarial communication, especially with regard to the use of economic scenario generators used in property/casualty insurer economic capital models.

6. Paragraph 3.3.2 – Fields of Expertise Used

This paragraph is requiring a depth of understanding inconsistent with the scope (of using models requiring specialized knowledge outside the actuary’s expertise). How can an actuary be expected to know if the model is based on “*currently accepted practices within the applicable fields of expertise*” for which the actuary is not an expert, without relying totally on an outside expert for this judgment. Wouldn’t that facet of a model’s usefulness be incorporated into any outside expert’s review of the model? As such, this paragraph is totally redundant with the requirement to rely on reviews of experts (Paragraph 3.4).

7. Paragraph 3.4 – Relying on Model Review by “Another Actuary”

I strongly disagree with the restriction that an actuary can only rely on reviews by other actuaries. This is an extreme example of inward thinking for the profession, ignoring the value of any outside profession until appropriately blessed by an actuary. I also note that only US actuaries are assumed to be reliable as only those reviews that follow ASOP 38 are deemed to be credible (and only those actuaries practicing in the US are subject to ASOP 38). This paragraph should allow for some form of reliance on experts from other professions.

8. Paragraph 3.7 - Documentation

Shouldn’t compliance with ASOPs be documented or verifiable (via an audit trail) as a general practice for all actuarial work? Why have it only in selected ASOPs such as this one? Please delete from here and, if needed, insert into a general practice standard.

Sincerely,

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