

## Emily Brown

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**From:** Michael Parker [michael.parker@towersperrin.com]  
**Sent:** 25 February 2009 16:39  
**To:** BAS Modelling  
**Cc:** Steve Presnell; Gerald McClushion; David Keeler; Charles Pickup  
**Subject:** Re: Modelling: Consultation Paper

The purpose of this email is to provide a Towers Perrin response to the September 2008 Consultation Paper on Modelling. I apologise for its submission slightly later than the deadline.

The consultation paper is a well articulated description of best practice modelling standards and the key is how to develop best practice into a mandatory coherent enforceable standard. The definition of model is sufficiently broad to apply to most of our consulting work across our employee benefits, life assurance and general insurance businesses.

However, since this consultation relates to the generic standard, much of the content is abstract. This makes it more difficult to provide detailed comments.

For users of actuarial information to gain the benefits of a modelling TAS, it will be critical that the actuaries preparing actuarial information have a clear understanding of what is required of them. Therefore, the proposed specific standards on Long Term Business, General Insurance and Pensions must give an opportunity for clearer insight and comment. Nevertheless, I set out below a summary of both our major issues and concerns, and further comment on points of detail.

In summary, our major issues are:

1. There is no clear description of the changes to current practice which the TAS is intended to drive. Clarity on these matters would help to elicit more helpful comment.

As explained in section 1.3, the modelling TAS will be principles-based.

We therefore expect that there will be considerable scope for subjectivity in interpreting compliance with the modelling TAS. Indeed, there were many different interpretations among our consultants who studied the paper. We urge the BAS to provide sufficient support to actuaries to clarify expectations, and to provide practical detailed guidance.

2. Principles based regulation sits at the heart of the FSA's strategy for the supervision of the Financial Services Industry. However, the FSA supports its principles based regulation with its own guidance, with regular speeches and newsletters giving views on particular issues, with themed reports highlighting good practice and bad practice found within the industry, and with a process of recognition of industry guidance when the industry itself steps in to establish practice which satisfies the rules.

The most obvious examples relate to treating customers fairly where the FSA has published considerable material on their website and where the ABI has stepped in with a number of guides on particular topics. One can only imagine that the FSA see the availability of this additional material as critical to the success of principles based regulation.

In our opinion, BAS will only meet its objectives if it can facilitate the availability of more detailed guidance which can be updated on a timely basis to deal with emerging issues. Does BAS intend to provide such support and if not, would BAS allow the Actuarial Profession to fill the void? In the many statements made where conformance with the statement is highly subjective, who is to decide on whether the model conforms?

3. The extent to which the nature and limitations of any tool within a model need to be disclosed either to internal users or clients is unclear.

Examples would be helpful.

4. Related to point 2, while the paper and associated FRC documents refer to materiality proportionality, for example in paragraph 3.5 of the paper, we have concerns that without more clarification legal advice on appropriate disclosures is likely to result in disproportionate caveats, additional cost and opaque disclosure to the client. We note that the FRC's "Actuarial Quality Framework" stresses the need for actuarial information and advice to "include sufficient information to enable the reader to judge the appropriateness and implications of any recommendations, without being obscured by immaterial or irrelevant information". Drawing the line on

materiality and "where an assumption, data item or other piece of information contributing to the development or use of a model whose effect on the model outputs is such that it could influence the decisions to be taken by the intended recipients of the work product" will be a big challenge.

5. Some disclosures may have commercial value. Is it expected that organisations which provide a service on economic scenario generation will be expected to divulge the details of their model?

6. In some of our work, our task is to do the best we can in a very short time scale. An example would be advising a potential acquirer on an acquisition. Would it be possible to provide actuarial information which is based on models which do not conform to the modelling TAS? Would it make any difference if our client placed a greater benefit on meeting the deadline than on having actuarial information which satisfied the modelling TAS? To some extent this issue is addressed in the Scope & Authority of Technical Standards document, but actuarial information prepared for one purpose is often made available and taken into account in a different context. In this example, actuarial information prepared as part of a due diligence exercise (but not in conformance with a modelling TAS) could be used as input into reserved work (such as impact on Group Solvency).

Turning to points of detail, many of which relate to the major issues listed above, and cover many of the questions set out in Section 8 of the

paper:

re 2.9 - We have concerns about potential impractical literal reading ie the degree of detail in explanations, and the consequences for the desired transparency and comprehensibility.

re 3.5 - We suggest it would be helpful to add "reasonably be expected to" before "influence" in the penultimate line.

3.15 We suggest that 3.15 should be expanded to clarify the intent, in particular whether it is considered necessary for the documentation of a model to be made available to the recipient of the actuarial information.

3.22 - Again we consider that this principle on proportionality is unhelpfully vague and needs amplification/clarification We consider 3.27 to be worded reasonably, if documentation is proportionate.

We suggest that 4.8 and 4.11 perhaps need more guidance on likelihood testing In 4.12, we suggest that the words "seek to" should follow "Models should"

The principle in 4.17, seems acceptable, but it would be helpful if it were clearer how is "material difference" is expected to be assessed?

re 5.13 - While incompleteness of data may have adverse effects, it should be noted that in some circumstances it may well be acceptable to make prudent assumptions about missing data.

5.19 suggests that estimates of the effect of data shortcomings need not be provided, on the grounds that they would be too difficult to apply in practice. This comment, which we support, should be cross-referenced to, and consistent with, the corresponding reference in the Data TAS.

5.28, 5.35 and 5.51 seem to be acceptable principles.

We disagree with the inclusion of 5.29 in the generic standard, and consider the specific TASs to be a more appropriate location.

re 5.42 and 5.43 - See the comment above re disclosure and transparency, The statement in 5.63 is not true for "technical provisions" where margins for adverse deviation are expected to be included.

We disagree with the suggestion at the start of 5.67.

re 5.77 and the comments on the Reporting TAS - it would be helpful to have more detail, or examples of a measure of material uncertainty.

re p34 questions- In 11 a), prudence is ill-defined, so we consider the concept to be unhelpful, although we note that "any appropriate principles on prudence are more likely to be addressed in specific standards". On 11b), the proposed approach would be best practice but it is not practical to require it for all assumptions.

re 6.6 - We suggest the addition of the word "significant" before "aspect".

re 6.8 - Again, while there should be a process to demonstrate the ongoing fitness for purpose, see the comments above re disproportionate effort and transparency.

We consider that 6.17 (to which question 15 refers) should refer to proportionality.

re 6.20 - We suspect that this requirement will be highly problematic.

Even if a deterministic model will "automatically" qualify, and that this only applies to more complex models, many users will know that there can be significant limitations with models but they still provide some information on which judgements can be made.

6.28 and 6.33 seem to be acceptable principles.

re 6.52 - We consider that a context should be set for reasonableness.

re question 15 (page 42), back-testing may not be relevant to many models, but we suspect that there would some difficulties in explaining differences between what happened and the model. We suggest that this is another example of what may be best practice, but not practical a requirement.

re question 19 (page 48) - Limitations of a model include changes in correlations at extreme ends and possible error in understanding consumer reaction and management actions. Would such issues be categorised as model limitations?

re 7.29 - Once again, see comment above re transparency.

re 7.34 - As we have clearly indicated, we strongly agree with the identification of the risk of overloading with provisos and hedges, which may be ignored because of too much detail, or because they become over-familiar/expected.

re 7.41 - Again, we have concerns that repetitive standard wording may not be heeded.

Finally, we suggest that A4 could have referred to professional judgement / the "sniff test" that can be developed with experience, but we accept that this is difficult to record as an enforceable principle!

I hope these comments are helpful. We will be prepared to expand or elaborate on them, if necessary.

Michael

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Michael Parker FIA, FSAI  
Principal  
Towers Perrin Human Capital Group  
71 High Holborn  
London WC1V 6TP  
Direct dial (44) (0) 20 7170 3817  
Fax (44) (0) 20 7170 2222

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