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AMERICAN ACADEMY *of* ACTUARIES

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April 12, 2011

Mel Anderson  
International Accounting Standards (EX) Working Group  
National Association of Insurance Commissioners  
Via email: Mel.Anderson@arkansas.gov

Re: IAIS ICP 14: Valuation for Solvency Purposes

Dear Chairman Anderson:

At the recent NAIC spring meeting, the American Academy of Actuaries'<sup>1</sup> Solvency Committee was asked if it could assist the NAIC in crafting its response to the IAIS regarding ICP 14: *Valuation for Solvency Purposes*. The attached comments are not Academy positions; they are suggestions for you to consider as you craft your response. These comments are in addition to the previous comments submitted in March.

If you have any questions, please submit them to Tina Getachew, Senior Policy Analyst, Risk Management and Financial Reporting Council, by phone (+1 202/332-5958) or email (getachew@actuary.org).

Sincerely,

R. Thomas Herget, FSA, MAAA, CERA  
Chair, Solvency Committee  
American Academy of Actuaries

CC: Rob Esson, NAIC Resson@naic.org  
CC: Larry Bruning, NAIC Lbruning@naic.org  
CC: Julie Gann, NAIC jgann@naic.org

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<sup>1</sup> The American Academy of Actuaries is a 17,000-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.

## Overall ICP Comment Template

Please refer to the *Consultation Guide* for details regarding the status, supporting documentation and how to comment on the individual ICPs. Comments in this overall comment template should focus on changes as a result of the FSB recommendations and consistency and duplication issues within the context of the overall ICP material.

The deadline for comments from Members and Observers is **Tuesday 19 April 2011**.

Comments should be sent to the Secretariat ([Nancy.Sinclair@bis.org](mailto:Nancy.Sinclair@bis.org)).

Name/jurisdiction	Paragraph reference	Comment	Proposed resolution (for use of the Secretariat only)
American Academy of Actuaries	14.0.3	"It does not consider "traditional" approaches to <u>solvency</u> ". Unclear what 'traditional approaches to solvency' means.	
American Academy of Actuaries	14.0.4	"...of IAIS risk-based solvency requirements that reflect a total balance sheet approach <del>on an economic basis</del> and address all reasonably foreseeable and relevant material risks."	
American Academy of Actuaries	14.0.5	"...for the recognition and valuation of assets and liabilities for <u>solvency</u> purposes." From the P&C perspective, it is understood that the "assumptions" underlying them should not be inconsistent (i.e., no contradictory assumptions). This is not the same as using the same measurement attribute.	
American Academy of Actuaries	14.0.8	"...include a set of financial statements which <del>may</del> differ from those used for general purpose financial reporting.	
American Academy of Actuaries	14.0.9	Suggest inserting in the beginning of the section. [At the same time, valuation of liabilities should not allow for a profit to be recognized prior to coverage being provided to the insured.]	
American Academy of Actuaries	14.1.4	Suggest inserting "...in relation to insurance contracts" [may be theoretically correct in many cases. In other cases, it is unclear as to whether a liability truly exists on the bound date, as the binding may only be a promise to make a currently unquantified promise, and only if a contingency is met. For reinsurance contracts, however, to do so could require the reinsurer to recognize a liability for a contract that the ceding carrier has not yet sold.]. Suggest deleting <u>is conceptually correct</u> .	
American Academy of Actuaries	14.1.6	Suggest inserting [No profit should be earned before coverage is provided]. "This would mean that <del>premium received or receivable would be offset against</del> the liability recognised for the contract in the period between the bound date and the inception date of the contract"	

Name/jurisdiction	Paragraph reference	Comment	Proposed resolution (for use of the Secretariat only)
		Suggest inserting [would equal premium received or receivable] “unless the contract is onerous”.	
American Academy of Actuaries	14.1.9	The statement is not correct. The value is nil until the inception date only if the contract is not or does not become onerous.	
American Academy of Actuaries	14.2	This is not correct for P&C claim liabilities or for UPR. This entire section does not apply to most P&C contracts and companies. Suggest inserting “..consistent bases” [for long duration contracts.]	
American Academy of Actuaries	14.2.1,14.2.2	Statements should specify life insurers. For example “...asset-liability positions of [a life] insurer and an understanding of the financial position of [a life] insurer”	
American Academy of Actuaries	14.3.1	“The values placed on the assets and liabilities of an insurer for solvency purposes should be a reliable measure of their value at the date of solvency assessment.” This implies a current value for all assets and liabilities which would seem to prohibit an amortized cost valuation for assets that is not necessarily an essential standard.	
American Academy of Actuaries	14.3.4	The supervisor should evaluate such circumstances. Furthermore, Suggest inserting [The supervisor may conclude that] the use of an amortized cost valuation may be an appropriate valuation for assets and liabilities in certain circumstances.”	
American Academy of Actuaries	14.3.7	“...across jurisdictions. If an insurer uses an internal model, in particular, the” Suggest inserting [description tails of the model and the validation results (actual to expected) and process should be included in the public disclosures.]	
American Academy of Actuaries	14.4	“economic valuation.” For liabilities that involve litigation, it is not clear that “economic valuation” is the most useful estimate.	
American Academy of Actuaries	14.4.1	Suggest inserting after “transparency and comparability.” [An economic valuation does not prohibit use of values other than fair value or market values for asset and liability values. For liabilities subject to material litigation uncertainty, it may not be appropriate to include estimates of time value and risk in the reported liability, due to the unreliability of such adjustments].	
American Academy of Actuaries	14.5.1	Suggest inserting after ...“valuation of cash flows.” [Where material uncertainty exists, the supervisor should evaluate the extent to which the time value and risk adjustments add useful information. Where this is not the case, the disclosure requirements may be relied upon.]	
American Academy of Actuaries	14.5.2	Suggest inserting “...in determining the economic value of an asset or liability [if they are valued on a market value basis].	

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American Academy of Actuaries	14.5.3	Suggest inserting [While]” the historic cost...”[ it may be an appropriate method for valuation when reliable, more current values than the entry price are not available or to the extent it allows consistent valuation of assets and liabilities] <del>Historic cost generally do not fully reflect changes in value over time. The valuation of technical provisions solely on the basis of premiums charged to the policyholder reflects the terms on which risk has been transferred from individual policyholders to an insurer but generally does not provide a reliable and relevant measure of the value of an insurer fulfilling its obligations. The premium charged will inter alia reflect the market cycle which is driven by considerations other than the value of obligations attaching to the policy. Instead, the valuation should be prospective, looking at the obligations to be met, rather than retrospective, looking at the premiums charged which may or may not turn out to be adequate to cover the costs of meeting the insurance obligations. However, the actuarial or other analysis of the prospective cost of the insurance obligations underlying the premium charged often provides useful valuation information, especially in the period immediately following the charging of the premium. This would prohibit use of a UPR method.</del>	
American Academy of Actuaries	14.5.5	The description of market-consistent valuation that follows does not imply that use of a market-consistent valuation is a preferred or better method of valuation than other methods.	
American Academy of Actuaries	14.7	Suggest inserting “The valuation of technical provisions exceeds [ equals] the Current Estimate by-[plus] a[n explicit] margin (Margin over the Current Estimate or MOCE).”	
American Academy of Actuaries	14.7.1	Suggest inserting “...uncertainty of those obligations. [As with any accounting measure, there is a presumption that reliable valuation of these components is achievable.]	
American Academy of Actuaries	14.7.4	Suggest inserting “...is their expected present value” [(also called the statistical mean)]	
American Academy of Actuaries	14.7.6	Suggest inserting after “...life time of the policy.” [In addition, the MOCE should be large enough to eliminate any potential gain at issue.]	
American Academy of Actuaries	14.7.9	Suggest inserting “A change in underlying data or assumptions generating a [change in] current estimate”	
American Academy of Actuaries	14.7.16	<del>When combined with the second building block, the first building block is akin to the current estimate as set out in 14.8 below. The third building block is akin to the MOCE when combined with the</del>	

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		<p><del>second building block as set out in 14.9 below. If the current estimate and MOCE are determined separately for solvency purposes and the IFRS were to apply for general purposes financial reporting, comparisons would be made between the current estimate determined under IFRS (adjusted for the time value of money) with the current estimate determined for solvency purposes and any differences explained. Similarly, the risk adjustment determined under IFRS would be compared with the MOCE and any differences explained.</del></p> <p>A comparison with IFRS is irrelevant to statutory accounting, particularly since the IFRS standard may change in the next few months.</p>	
American Academy of Actuaries	14.8	Suggest inserting after "...cover in the future" [and it creates an onerous contract.]	
American Academy of Actuaries	14.8	A reinsurance contract may obligate a reinsurer to take all amounts over a certain amount but setting up an obligation for contracts not yet sold is illogical.	
American Academy of Actuaries	14.8.3	Language should be revised to be consistent with the new IFRS language. Otherwise, this will not work well for health insurance contracts.	
American Academy of Actuaries	14.9.2	Suggest inserting after "...insurer's insurance obligations" [plus an amount necessary to prevent a gain being realized at issue]	
American Academy of Actuaries	14.9.9	Suggest inserting "...diversification across portfolios [should] be addressed as an offset to regulatory capital requirements [if appropriate]. The MOCEs for the total business of the insurer would simply be the sum of the MOCEs of the [its] portfolios	
American Academy of Actuaries	14.10.2	Suggest inserting after "...nature as appropriate". [The use of a bottom – up (risk free-based) discount rate starting point or the use of a top-down (asset-yield based) discount rate starting point are equally valid and can be chosen by the supervisor based on ease of implementation.]	