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January 31, 2017

Maryellen Coggins
Chairperson
Actuarial Standards Board
1850 M Street NW, Suite 300
Washington, DC 20036
Via email to: comments@actuary.org

Re: Proposed Actuarial Standard of Practice, *Capital Adequacy Assessment for Insurers*

Dear Maryellen:

On behalf of the Enterprise Risk Management and Own Risk and Solvency Assessments (ERM/ORSA) Committee of the American Academy of Actuaries,¹ I appreciate the opportunity to provide comments on the exposure draft of the proposed actuarial standard of practice (ASOP), *Capital Adequacy Assessment for Insurers*.

The current draft of the ASOP provides good information for actuaries involved in performing capital adequacy assessments. The primary purpose of our review of the draft was to identify significant issues or concerns regarding the content of the draft. In addition, we have the following general suggestions for the improvement of the ASOP:

General Comments:

- The purpose of this standard should be stated more clearly. We understand that the goal of this ASOP is to provide a general practice standard for insurer's forward-looking assessment for capital. Therefore, we recommend changing the definition in "2.3 Capital Adequacy Assessment" to "Prospective assessment of projected available capital of the insurer relative to its projected risk capital target (or projected risk capital threshold)."
- There are limitations in the evaluation of target capital approaches. We recommend including requirements that actuaries recognize and communicate the limitations surrounding the evaluation of target capital and their impacts on the capital assessment.

¹ The American Academy of Actuaries is a 19,000+ member professional association whose mission is to serve the public and the U.S. actuarial profession. For more than 50 years, the Academy has assisted 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.

- Liquidity is an important component of capital adequacy. We recommend including more commentary on liquidity aspects of a capital assessment.
- Currently, the capital adequacy assessment definition specifies application to the insurer. We recommend revising the definition of capital adequacy assessment to include the capital adequacy assessment of complex insurance organizations to address considerations at the group level.
- We believe that validation of target capital would be addressed in the risk evaluation standard. However, we believe that this ASOP should address the validation or reasonableness of available capital and capital adequacy levels (i.e., reasonableness relative to external models such as rating agency and regulatory models).

We have the following suggestions in the following sections of the current draft of the ASOP:

Section 2:

- We propose adding definitions for risk management and capital management policies.
- We recommend adding a definition for “fungibility.” Actuaries outside of the ERM space may not be familiar with this terminology.
- We suggest adding a definition of “economic environment,” a term that appears in Sections 3.1.a, 3.4.c, and 4.1.b, so that the definition includes the following components:
 - Systemic insurance environment;
 - Systemic global economic environment; and
 - Internal company environment.

Section 3:

- Section 3.1.b—Consider expansion of this item to address:
 - Reasonableness of assumptions underlying strategy and planning;
 - Consistency of strategy and planning with the company’s policies, overall business, and growth plan;
 - Documentation supporting the successful execution of strategies and plans; and
 - Impact of stressed conditions and timing on the success of strategies and plans.
- Section 3.2.b—Consider the following revision: “including the relationship ~~any conflicts~~ between the risk profile and the risk appetite.”
- Section 3.6.1—Consider the addition of stochastic scenario testing because it is commonly employed in capital adequacy assessments.
- Section 3.8.b.3—Consider changing “countries” to “jurisdictions” to also recognize state differences where it states “expected regulatory changes in some countries.”

- Section 3.10, “Reliance on Data or Other Information Supplied by Others,” references relevant ASOPs, such as ASOP No. 23, ASOP No. 38, and ASOP No. 41. For the purpose of this ASOP, reliance on external sources may go beyond data or models currently referenced in the draft (i.e., relying on external judgment or analysis). When relying on such external knowledge, evaluation of quality of data and the evaluation of the expertise of those whose analysis is relied on should be considered. Evaluation of expertise is particularly important in evolving areas of actuarial practice. Because evaluation of expertise is a consideration in many functions of an actuary, it may be more appropriate to address such external source reliance and evaluation of expertise in ASOP 1 or 41, with reference to these ASOPs in the capital adequacy ASOP.

Section 4:

- If the capital adequacy assessment includes manual adjustment or expert judgment, supporting evidence or documentation should be provided (this could be included in Section 4.2).
 - A company may have made a manual adjustment at the reserve level that should be considered in the capital requirement. (For instance, data issues could sometime cause valuation challenges, and an actuary may make an adjustment based on his/her best estimation). Capital also should reflect those adjustments if the capital is a function of liabilities (i.e., C-2 risk). In this case, supporting evidence or documentation that covers such one-off adjustments at the reserve level should be provided.
- Section 4.2.c—Consider the following revision: “If the actuary had a role in the design of or reviewed the risk capital targets or risk capital thresholds, the actuary should consider disclosing ~~disclose~~ his or her role and the rationale underlying the design or the results of his or her review (see sections 3.4 and 3.5).” It seems onerous to require such a disclosure when it may be irrelevant in some contexts (e.g., a capital adequacy assessment intended solely for internal use, or as an element of due diligence for a proposed transaction).

Thank you for this opportunity to provide our views on the current draft of a proposed actuarial standard of practice, *Capital Adequacy Assessment for Insurers*. If you have any questions or would like to discuss this letter in more detail, please contact Nikhail Nigam, the Academy’s policy analyst for risk management and financial reporting issues, at 202-223-8196 or nigam@actuary.org.

Sincerely,

Seong-Min Eom, MAAA, FSA
 Chairperson, ERM/ORSA Committee
 Risk Management and Financial Reporting Council
 American Academy of Actuaries