



AMERICAN ACADEMY *of* ACTUARIES

August 4, 2010

Alfred W. Gross
Chair, Statutory Accounting and Financial Reporting (EX) Subgroup
National Association of Insurance Commissioners
Sent via email: ddavelin@naic.org

Re: Exposure Document – Primary Considerations

Dear Commissioner Gross:

On behalf of the Financial Reporting Committee and Risk Management & Solvency Committee of the American Academy of Actuaries¹ (Academy), we appreciate this opportunity to provide comment on the June 2010 *Primary Considerations* for the Statutory Accounting and Financial Reporting (EX-SMI) Subgroup, providing primary considerations around the following three questions:

1. What should be the purpose of the regulatory accounting model?
2. Given that the IAIS and major jurisdictions are advocating the use of IFRS (possibly with modifications) for regulatory purposes, should the NAIC continue to maintain an entire codification of statutory accounting?
3. Should regulatory financial statements be utilized for public purposes or should a separate public financial filing be required?

In general, we felt that the discussion document was well-written and useful. As such, our comments will focus on providing views on the three questions themselves, rather than addressing the discussion document.

General Comment

We believe it is important to highlight the need for coordination between the decisions reached by your subgroup and other aspects of the NAIC's Solvency Modernization Initiative, most notably the Risk-Based Capital (RBC) Modernization project recently begun by the Capital Adequacy Task Force's (E) SMI Subgroup at the request of the Solvency Modernization Initiative Task Force.

Many aspects of the existing RBC formulas are implicitly dependent on the underlying accounting basis. In principle, just as the existing NAIC RBC formulas were designed to be compatible with existing NAIC statutory accounting, it should be possible to devise a solvency

¹ The American Academy of Actuaries is a 17,000-member professional association whose mission is to serve the public on behalf of 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.

monitoring methodology that is compatible with whatever basis of accounting insurers use in the financial statements filed with insurance regulators. Consequently, any material changes in the underlying regulatory accounting basis would need to be accompanied by a careful review of risk-based capital and implementation of conforming changes within RBC.

Question 1

What should be the purpose of the regulatory accounting model?

The underlying purpose of a regulatory accounting model is to aid insurance regulators in assessing the ability of a company to fulfill its obligations to policyholders and comply with laws and regulations relating to solvency.

An observation from this project is that the existing United States approach of a separate regulatory accounting basis (accompanied by a compatible solvency monitoring metric) may not be the only viable path to achieving this underlying purpose. The material quoted below is excerpted from the March 2010 response of the Academy's Regulatory Capital Requirements Task Force to the *Consultation Paper on Regulatory Capital Requirements and Overarching Accounting and Valuation Issues for the Solvency Modernization Initiative* put forward by the International Solvency (EX) Working Group², specifically in response to question #42, "Should valuation differ between public financial reporting (GAAP) and supervisory financial reporting (SAP)?"

"Valuation does not have to differ between GAAP and SAP; Canada has had a single standard for many years. Even if a GAAP accounting system produces a more income statement - oriented approach, its resulting balance sheet could be modified for a sharper view of solvency. Any alternative accounting system used for solvency will need to have adjustments made in order to be suitable for solvency purposes. A major argument for a single accounting system is that under a total balance sheet approach the reserves do not really matter since they are just subtracted from the total assets needed to produce the capital.

Several desirable attributes of an accounting system most suitable for solvency measurement would include: a) liabilities determined on a single model; b) a uniform degree of conservatism (or even no conservatism) in all liabilities; c) a discount rate that reflects what assets are likely to earn; d) consistency between discount rates used for liabilities and assets; e) loss recognition / asset adequacy analysis; and f) a single view of amortized cost / current values for both assets and liabilities, as well as for all liability calculations.

Insurer policy provisions, investment quality, and management practices will have far more impact on insurer solvency than the valuation basis selected to measure it. The amount of total assets needed to assure solvency is not dependent on the methods used to calculate liabilities. A total asset methodology should be independent of how much reserve is held, within some broad limit such that there isn't such a small capital requirement and high reserve requirement that companies routinely violate the equity requirement.

This discussion is not, however, an endorsement of the use of GAAP for statutory accounting purposes; there are many considerations that need evaluation before such a step is taken."

² Available at http://www.actuary.org/pdf/finreport/isftf_mar10.pdf

We continue to support these previous comments.

Question 2

Given that the IAIS and major jurisdictions are advocating the use of IFRS (possibly with modifications) for regulatory purposes, should the NAIC continue to maintain an entire codification of statutory accounting?

As noted within the June exposure document, the current linkage between US federal income taxation and statutory accounting is significant. Unless this situation is appropriately addressed, it may be difficult to move away from the current statutory system.

Acknowledging that: if over time IFRS methods for evaluating insurance assets and liabilities become widely recognized as being a reasonable and useful approach, then it would be appropriate for the NAIC to consider adopting IFRS, in total or in piecemeal.

In the event that the NAIC decides that a migration to IFRS for regulatory purposes is warranted, we still foresee a continued need for the NAIC to maintain some form of regulatory accounting guidance. Guidance would be needed to apply general principles to a US-specific environment, to address situations not anticipated today, and to facilitate the performance of financial audits and/or regulatory examinations.

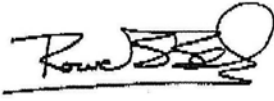
Question 3

Should regulatory financial statements be utilized for public purposes or should a separate public financial filing be required?

We suggest that the NAIC should reconsider, from a public policy standpoint, which aspects of an insurer's financial condition belong in the public domain and which aspects instead should be communicated in confidential fashion to regulators. The exposed document did not, in its discussion of this question, provide the underlying rationale for why insurers should file public reports of financial information, in addition to providing insurance regulators with confidential information so that they may assess company solvency. Clearly, today there are many non-regulator parties that make extensive use of the information found in insurers' regulatory financial statements, for different purposes.

Thank you again for this opportunity to provide input. If we can be of further assistance, please contact the Academy's senior risk management & financial reporting policy analyst, Tina Getachew, at getachew@actuary.org or (202) 223-8196.

Sincerely yours,

A handwritten signature in black ink, appearing to read "Rowen B. Bell". The signature is stylized with a large, circular flourish at the end.

Rowen B. Bell, FSA, MAAA
Chair, Financial Reporting Committee
Risk Management & Financial Reporting Council

A handwritten signature in blue ink, appearing to read "R. Thomas Herget". The signature is written in a cursive, flowing style.

R. Thomas Herget, FSA, MAAA, CERA
Chair, Risk Management & Solvency Committee
Risk Management & Financial Reporting Council