AMERICAN ACADEMY *of* ACTUARIES

April 30, 2010

Rob Curtis
Chair, Solvency and Actuarial Issues Subcommittee
International Association of Insurance Supervisors
Via email to: Rob.Curtis@fsa.gov.uk
CC: Secretariat John.Maroney@bis.org

To: International Association of Insurance Supervisors

Re: AAA comments on the IAIS *Guidance Paper on Capital Adequacy for Regulatory Solvency Purposes*

The American Academy of Actuaries'[1] Risk Management and Solvency Committee (RMSC) has completed a review of the February 26 draft IAIS Guidance Paper and prepared the attached comments in the format requested by the IAIS.

On behalf of the American Academy of Actuaries' Risk Management and Solvency Committee, I wish to thank you for the opportunity to comment. Should you have any questions or need further information on our comments, please feel free to contact Senior Risk Management and Financial Reporting Policy Analyst, Tina Getachew, at getachew@actuary.org or at (202) 223-8196.

Sincerely,

R. Thomas Herget

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

[1] The American Academy of Actuaries ("Academy") is a 16,000-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

Member and Observer Comments on IAIS Draft paper:
Guidance paper on Capital Adequacy for Regulatory Solvency Purposes
Draft, 26 February 2010

Comments due by 30 April 2010

Name	Section or paragraph reference	Comment	Resolution (for use of the Secretariat only)
American Academy of Actuaries (AAA)	Paragraph 14 and paragraph 22 (also referenced in paragraph 123)	The term "economic value" is used throughout the paper. Paragraph 14 states that "this paper does not focus on matters relating to valuation." However, the guidance refers to a consistent measurement of assets and liabilities. Per footnote 9, we feel that the intention is not to advocate a particular methodology. References to specific methodologies should be removed and the paper should remain neutral in advocating methodology.	
AAA	Paragraph 16	It is not clear on what basis a group review is to be done or by whom. By way of example, if a company is domiciled in Luxembourg but does most of its business in the UK and France, who should do the group review? All three countries? It is also not clear on what basis (the standards of Luxembourg, UK or France in this example) the review should be done.	
AAA	Paragraph 24	Technical provisions and required capital have, in part, the same role – to assure that benefits can be paid. The distinction between them is the order in which they are relied upon to do so. Required capital is an amount the insurer holds to fulfil its insurance obligations and settle all commitments to policyholders should the technical provisions prove to be inadequate to do so.	
AAA	Paragraph 26	The paragraph refers to certain circumstances where subordinated debt may be considered as capital. Under what	

		circumstances can this happen? It should be explained.	
AAA	Paragraph 31	In the next-to-last sentence, it sounds like non-insurance entities are being excluded from consideration. This should only be the case if affiliates have no call on the insurer's capital or liquidity.	
AAA	Paragraph 62	The paragraph would read better if the fifth word in the second sentence were changed from "to" to "from."	
AAA	Paragraph 66	Figure 2 could be clearer. Some terms should be defined (e.g., "Current Estimate"). It should be stated that the two bars are equal (notice that their height is not).	
AAA	Paragraph 78	While the wording in this paragraph is not totally clear, we recommend stating that future capital injections should not be assumed in evaluating the solvency of a company.	
AAA	Paragraph 91	We recommend listing Conditional Tail Expectation as an example.	
AAA	Paragraph 94	During these shock tests, what assumptions should be made about non-guaranteed elements, such as excess interest? Can the Guidance specify what to do about discretionary items so that all companies perform this test consistently? The ability of an insurer to reduce capital requirements by assuming future management actions (e.g., dynamic hedging, lowering credited rates, lowering policyholder dividends, changing premium rates and the resulting impact on policyholder behavior) does not appear to be discussed to a significant extent, either in stress testing or regular scenario testing. We believe that such effects need to be measured but the changes need to be reviewed for reasonableness.	

AAA	Paragraph 110	Diversification across international boundaries is particularly difficult to realize because regulators have obligations first to their own domestic policyholders and the fungibility of money across international boundaries is particularly limited.	
AAA	Paragraph 187	The ORSA will be established if the ERM standard is adopted.	
AAA	p.47, footnote 44	This footnote discusses economic capital in paragraph 202. Economic capital is first addressed in paragraph 185 on page 44. This footnote should be associated with paragraph 185 since it precedes paragraph 202.	
AAA	Not mentioned	Frequency of calculation. The Guidance should address the frequency of performing Capital Adequacy tests. The trend may be more important than the actual number. For some product lines a year is a short time. Also, for weakly capitalized companies, a year can be a short time. The guidance should encourage the regulator to request calculations more frequently than annually where warranted.	
AAA	Not mentioned	Definition of insurance. Capital Adequacy is needed for all insurance enterprises. When companies buy insurance on their liabilities from reinsurers, the reinsurer is regulated. When companies buy insurance (such as credit default swaps or letters of credit) on their assets, there may be no regulation of these assurers. Capital Adequacy needs to apply to all types of insurance.	
These next two comments are intended to be observations.			
AAA	Paragraph 41	The USA has performed asset adequacy analysis for over twenty years. To perform these tests, assets have been assigned to lines of business. Generally, the higher quality	

		assets have been associated with lines of business (supporting investment-oriented products) and thus illiquid, marked-down or impaired assets relegated to surplus (capital). To treat capital resources as a specific pool of assets while the paper refers to the total balance sheet approach seems in conflict.	
AAA	p.16, Requirement 6	Requirement 6 states that "The regulatory capital requirements in a solvency regime establish a solvency control level which defines the level above which the supervisor would not require action to increase the capital resources held or reduce the risks undertaken by the insurer. This is referred to as the Prescribed Capital Requirement (PCR)." Might there be a situation where a supervisor would want to require action solely due to an issue with an insurer's PCR or the PCR methodology itself?	