



AMERICAN ACADEMY *of* ACTUARIES

**Comments on the Corporate Governance for Risk Management Act (draft)
Corporate Governance for Risk Management Model Regulation (draft)
From the American Academy of Actuaries' Life Governance Team**

**Presented to the National Association of Insurance Commissioners'
Capital Adequacy Task Force**

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The American Academy of Actuaries is a national organization formed in 1965 to bring together, in a single entity, actuaries of all specializations within the United States. A major purpose of the Academy is to act as a public information organization for the profession. Academy committees, task forces and work groups regularly prepare testimony and provide information to Congress and senior federal policy-makers, comment on proposed federal and state regulations, and work closely with the National Association of Insurance Commissioners and state officials on issues related to insurance, pensions and other forms of risk financing. The Academy establishes qualification standards for the actuarial profession in the United States and supports two independent boards. The Actuarial Standards Board promulgates standards of practice for the profession, and the Actuarial Board for Counseling and Discipline helps to ensure high standards of professional conduct are met. The Academy also supports the Joint Committee for the Code of Professional Conduct, which develops standards of conduct for the U.S. actuarial profession.

Life Governance Team

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The Life Governance Team of the American Academy of Actuaries has reviewed the NAIC draft Corporate Governance for Risk Management Act (“Act”) and the accompanying Corporate Governance for Risk Management Model Regulation (“Regulation”). Both documents were exposed for comment by the NAIC’s Capital Adequacy Task Force (CADTF).

Both the proposed draft Act and the Regulation attempt to link principles-based approaches to valuation to broader regulation of risk management. The draft Act and Regulation have a scope that extends beyond principle-based valuations. They are intended to regulate the risk management practices of all authorized insurers doing business in a state that adopts the law, regardless of whether they employ principles-based valuations. They impose specific requirements on a company’s board of directors and grant the commissioner authority to expand those requirements by regulation. They also authorize states to impose punitive penalties for non-compliance.

Only certain portions of the draft Act and Regulation address issues related specifically to principles-based reserves and capital. Risk-management governance and principles-based governance are distinct issues. They will be addressed separately in this comment letter.

Governance for Risk Management

Both the Act and the Regulation deal with regulating internal company management processes in a way that extends beyond current regulatory control over corporate governance and well beyond statutory issues. This proposed regulatory control deserves careful scrutiny for several reasons.

First, such new regulations may not be needed because:

- The NAIC’s new Risk Focused Surveillance framework includes substantial review of a company’s risk management and control processes, which will guide the scope and depth of future regulatory examinations.
- Companies already have risk management systems in place in the form of concentration limits, asset class limits, underwriting retention limits, asset-liability matching, stringent controls over business and operating risks, etc.
- Actuarial judgment is already a significant component of insurance company financial reporting in the form of the assumptions and methods underlying GAAP reporting, asset adequacy testing, and various aspects of the calculations of life insurance company statutory reserves and capital.
- The rating agencies provide ongoing incentive to identify and manage risks. For example, Standard & Poor’s has added an assessment of a company’s risk management processes as a specific criterion for determining a company’s rating.

Thus, the existing environment should be considered before new regulations are added.

Second, the draft Model Regulation, in particular, takes ideas from a number of sources, the applicability of which has not been established for U.S. insurance companies.

- For example, the Regulation takes many concepts from the banking industry and Basel II
- A 2003 report from the independent Group of Thirty Consultative Group on International Economic and Monetary Affairs is the basis for several recommendations on governance/control practices.
- The Regulation also references various standards from the International Association of Insurance Supervisors.

More importantly, adopting concepts piecemeal from several different sources may result in losing the balance among various governance objectives and constraints that was ultimately reflected in each separate proposal.

Finally, the Act and Regulation could be interpreted as risk management “best practices.” While well-intended, the codification of these practices (many of which were taken from the banking industry) would not provide for the evolution of risk management tools and practices for U.S. insurance companies, and certain requirements might soon prove to be barriers to efficient and effective risk management.

Therefore, more time is needed to review specific provisions in the Act and Regulation, and to obtain the expertise of other professions since many of the provisions extend beyond the scope of the expertise of the actuarial profession.

The Team does have expertise to comment on governance related to principles-based reserves and capital. This is addressed in the following section.

Governance for Principles-based Reserves and Capital

Only small portions of the draft Act and Regulation are devoted specifically to principles-based valuations. In the draft Act, the only mention of principles-based valuations is found in three general sentences in Section 5. In the Regulation, principles-based valuations are addressed primarily in Section 7, “Certifying Actuary Statement and Certifying Actuary Report for Principles-based Valuations.”

The regulations relating to the Certifying Actuary such as the qualifications of the Certifying Actuary, the content of the Certifying Actuary’s Statement, and the contents of the Certifying Actuary’s Report should be in a Valuation Manual, as provided for in draft revisions to the Standard Valuation Law. With these topics addressed in the Valuation Manual, the regulatory framework would have the necessary flexibility to encompass new ideas and best practices as they emerge.

Academy work groups are already developing proposed governance procedures specific to principles-based reserves and capital on a number of fronts. The proposed valuation law itself contains such governance requirements as the charge to quantify all material risks, the need to engage an independent qualified actuary to conduct an annual detailed peer review, and provision of reports and other information to the Commissioner. The Valuation Manual referenced in the law, and Actuarial Standards of Practice, are expected to provide guidance with respect to assumptions, conservatism, modeling and “Other requirements deemed necessary by the NAIC....” Detailed supporting documentation will be required, including reports that would be available to state regulators. In addition, the current draft revisions to the Standard Valuation Law also include authority for the state Commissioner to conduct an additional independent review.

Thus, the proposed principles-based approach will provide a rigorous framework for governance in the form of standards, review processes, certifications, disclosures, required submission of company data, and regulatory powers. We expect that many of these standards and processes will be consistent with the proposed requirements in the draft Corporate Governance for Risk Management Act and Regulation. However, the Valuation Manual and Actuarial Standards of Practice would be a more appropriate location for these provisions.

The scope of internal corporate governance should be considered further as the exact requirements for principles-based approaches for valuation take form.

Conclusion

An appropriate risk management process for determining statutory reserves and capital should exist within companies, regardless of whether they use a principles-based approach. However, the need for governance in a principles-based approach does not necessarily translate into detailed regulation of a company’s entire risk management process. With respect to governance for principles-based valuations, we have in mind a process that identifies specific governance objectives, describes the policies and processes the company would need to meet these objectives, reviews the extent to which the framework being developed already includes needed governance, and assesses the extent to which additional regulations are needed.