AMERICAN ACADEMY of ACTUARIES

January 27, 1999

The Honorable James A. Leach, Chairman
House Committee on Banking and Financial Services
Washington, D.C. 20515

RE: Financial Services Reform

Dear Chairman Leach:

The American Academy of Actuaries recognizes your efforts to improve H.R. 10, now the Financial Services Act of 1999.

As your Committee prepares to hold hearings on H.R.10, the Academy would like to offer some observations about the implications of this legislation. The Academy neither supports nor opposes the bill, but believes that policymakers should adequately address all types of financial risks (i.e., insurance risk and investment risk) affected. Enclosed you will find a one page summary of the differences between insurance risk and investment risk.

With or without H.R.10, there are clearly trends toward blurring traditional distinctions among various types of financial risk. As companies and products mix elements of banking, investment, and insurance, it is important to ensure that companies provide adequately for their risk exposure so that the companies and their customers are appropriately protected against bankruptcy.

It is especially important that solvency standards provide adequate protection to cover the insurance risk. For example, bank holding companies which underwrite insurance products, such as mortgage guarantee insurance, need to have adequate capital and reserves to cover the risk of natural disasters. Actuarially adequate reserves and associated risk-based capital should be required regardless of what the business calls itself or whether the business operates at the holding company, operating company, subsidiary, or other level. The failure of such entities, with the accompanying harm to the American public, may be a predictable consequence of underwriting insurance products for which adequate capital and reserves and other consumer protections have not been established.

Insurance risk is particularly complex, requiring the selection and application of appropriate assumptions based on a highly trained and experienced understanding of the universe of those being covered, and the nature of the risks involved in each product. Actuaries are uniquely qualified to deal with the measurement and management of insurance risk. The Academy urges your Committee to protect the public and the financial system by providing for the appropriate application of actuarial skills in the newly emerging financial services world.

We would be happy to appear before your Committee and work with you and your staff to ensure that adequate protections are provided for the public and the financial services industry. The Academy can contribute to the discussion by sharing its report of findings based on its objective, nonpartisan actuarial analysis.

The American Academy of Actuaries is the public policy organization for actuaries of all specialties within the United States. In addition to setting qualification standards and standards of actuarial practice, a major purpose of the Academy is to act as the public information organization for the profession. The Academy is

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nonpartisan and assists the public policy process through the presentation of clear actuarial analysis. The Academy regularly prepares testimony for Congress, provides information to federal elected officials, regulators and congressional staff, comments on proposed federal regulations, and works closely with state officials on issues related to insurance. The Academy also develops and upholds actuarial standards of conduct, qualification, and practice, and the Code of Professional Conduct for all actuaries practicing in the United States.

Sincerely,

Lawrence A. Johansen, Vice President	Don Sanning, Chairperson
Financial Reporting Council	Task Force on Banking and Financial Services

Enclosure

cc: The Honorable Phil Gramm, Chairman
Senate Committee on Banking, Housing, and Urban Affairs

Members of the U.S. Senate
Members of the U.S. House of Representatives

Insurance Risk vs. Investment Risk

- “Insurance risk” is a risk of personal financial loss to the insured party, which can result from the loss of life, loss of health, loss of income due to disability, or loss through damage to or destruction of property such as a home or automobile.

- An increasing number of instruments are available to the consumer that involve both insurance risk and financial risk, such as fixed interest annuities.

- The risks associated with many insurance products can be of a catastrophic nature and large enough to threaten the solvency of banks that underwrite such products. For example, banks may want to offer mortgage guaranty insurance on homes for which they issued mortgages that would cover the mortgage in the event of damage to the property.

- Insurance risk is often extremely volatile, particularly if the insured pool for a particular product has not been adequately analyzed or properly selected.

- Banks and bank holding companies are generally inexperienced with the analysis and management of the risks associated with insurance.

- If Congress intends to protect the public from solvency risks, it should establish reserving requirements and other solvency standards for banks and bank holding companies similar to those established for insurers on those products with a significant element of insurance risk. Absent such capital and reserves, these institutions may be unable to pay policyholders’ claims.

- In order to protect the public, Congress should encourage uniform, adequate, and consistent solvency standards for entities assessing risk.

- Actuaries are professionals experienced in the management of insurance risk. Actuarial opinions and certifications that are currently required by state law and regulation are valuable tools to manage insurance risk. Therefore, we strongly suggest that any regulation of financial institutions’ underwriting activities should make provisions for appropriate actuarial involvement in the projection and management of insurance risk.