



**ASSOCIATION ACTUARIELLE INTERNATIONALE  
INTERNATIONAL ACTUARIAL ASSOCIATION**

May 3, 2004

Mr. Lonny McPherson  
International Association of Insurance Supervisors  
c/o Bank for International Settlements  
CH-4002 Basel, Switzerland  
(Email: [lonny.mcpherson@bis.org](mailto:lonny.mcpherson@bis.org))

Dear Mr. McPherson,

**Re: [Draft Supervisory Standard on Suitable Forms of Capital](#)**

The International Actuarial Association (IAA) appreciates the opportunity given to comment on the draft Supervisory Standard on Suitable Forms of Capital released March 12, 2004.

At this stage these comments represent the views of the Solvency Subcommittee of the Committee on Insurance Regulation only. The comments have not been approved formally by the Full Member associations of the IAA. We intend to submit these comments for due process and formal approval by the IAA membership and, in due course, will provide that formal response. In the meantime, these comments should be regarded as an informal commentary, rather than as a formal policy statement of the IAA.

If, upon reading these comments, you identify any points that you would wish to pursue, please do not hesitate to contact the chairperson of the Solvency Subcommittee, Stuart Wason, or any of the other members of the subcommittee. The IAA will be pleased to develop these ideas further with you.

Yours sincerely,

Yves Guérard  
Secretary General

Attachment

cc: Mr. Ruud Pijpers (Email: [j.pijpers@pvk.nl](mailto:j.pijpers@pvk.nl))  
Mr. Jukka Rantala (Email: [Jukka.Rantala@etk.fi](mailto:Jukka.Rantala@etk.fi))

**A Commentary on the  
DRAFT SUPERVISORY STANDARD ON SUITABLE FORMS OF CAPITAL  
Released by the International Association of Insurance Supervisors: March 2004**

**International Actuarial Association**

The International Actuarial Association (the “IAA”) represents the international actuarial profession. Our fifty Full Member actuarial associations represent more than 95% of all actuaries practicing around the world. The Full Member associations of the IAA are listed in an Appendix to this statement. The IAA promotes high standards of actuarial professionalism across the globe and serves as the voice of the actuarial profession when dealing with other international bodies on matters falling within or likely to have an impact on the areas of expertise of actuaries. The IAA appreciates the opportunity to provide comments on this IAIS document.

**Due Process**

These comments have been prepared by the Solvency Subcommittee of the Insurance Regulation Committee, the members of which are listed below by name and association. It is now intended that the comments will be circulated for approval to the Full Member associations of the IAA as part of our due process procedures. Accordingly, these comments do not constitute a formal response by the IAA. The final copy of this draft statement will be transmitted to the IAIS as soon as this draft statement has passed through the IAA’s due process.

**Members of the IAA Solvency Subcommittee**

Stuart Wason	Chairperson
H.W.M. Van Broekhoven	Vice-Chairperson
Rolf Stölting	Vice-Chairperson
Félix Arias Bergadà	Col.legi d'Actuaris de Catalunya
Anthony Bice	Institute of Actuaries
Allan Brender	Canadian Institute of Actuaries/Institut Canadien des Actuaire
Tenny Siu Pong Chong	Actuarial Society of Hong Kong
Anthony Coleman	Institute of Actuaries of Australia
John Norman Darvell	Faculty of Actuaries
R Kannan	Actuarial Society of India
Toshihiro Kawano	Institute of Actuaries of Japan
Philipp Keller	Association Suisse des Actuaire
Christoph Krischanitz	Aktuarvereinigung Österreichs (AVÖ)
Glenn Meyers	Casualty Actuarial Society
Harry H Panjer	Society of Actuaries
Manuel Peraita Huerta	Instituto de Actuarios Españoles
Frank Rasmussen	Den Danske Aktuarforening
Norma Alicia Rosas	Colegio Nacional de Actuarios A.C.
Richard Roth	Conference of Consulting Actuaries
Arne Sandström	Svenska Aktuarieföreningen
Nino Savelli	Istituto Italiano degli Attuari
Johanna Elizabeth Van Heerden	Actuarial Society of South Africa

## **Members of the IAA Solvency Subcommittee (cont.)**

Therese Vaughan

American Academy of Actuaries

Eret Võsa

Eesti Aktuaaride Liit

Roberto Westenberger

Instituto Brasileiro de Atuária IBA

## **IAA Comments**

The Solvency Subcommittee of the International Actuarial Association has reviewed the March 12, 2004 draft of the captioned paper and offers the following comments.

### **General remarks**

The IAA appreciates the opportunity to respond to this paper at a draft stage. The following are our detailed comments.

### **Introductory paragraph**

In this draft there is no introductory paragraph recognizing the differences between various concepts of capital. To address this, the following paragraph is suggested. This may be introduced after paragraph 1 of the draft (page 2):

“Economic capital differs from accounting capital and regulatory capital. While accounting capital views capital as a source of funding and risk has no bearing on it, regulatory capital attempts to reflect different liquidity characteristics and different levels of capacity to absorb losses. Thus economic capital is defined as aggregate amount of capital that is required as a cushion for an insurer's unexpected losses due to all risks. Insurance companies frequently use the concept ‘free surplus’, which refers to the excess of assets over liabilities and regulatory capital requirements.”

### **Paragraph 5**

Editorial correction, replace: “In addition to the broad definition of capital in paragraph 1” by “As mentioned in paragraph 2”.

### **Paragraph 10**

The present paragraph is not clear. Hence add the following at the end of paragraph 10:

“Since net income is often measured as a rate of return on investor equity, many insurers aim to maintain actual capital as close as possible to economic capital in order to maximize return on equity.”

### **Paragraph 13**

The dynamic characteristic of regulatory capital is not spelt out clearly. To address this, add the following in paragraph 13, after the sentence ending with “... in a wind up or run off scenario”:

“As regulatory capital is based on ongoing dynamic insurer's business, it has aspects of both the going concern and run-off situations. Hence one cannot view regulatory capital as determined solely on a going concern basis or on a run-off basis.”

### **Paragraph 15**

The rationale of hidden value is not brought out clearly in paragraph 15. Hence delete the first sentence in paragraph 15: “Jurisdictions may require ... in the assets and liabilities.” In this place add the following:

“Having recognized the definition of capital as the different between the value of assets and liabilities, it is important to acknowledge that the capital value is directly dependent on the relative strength of the methods and assumptions used to determine the asset and liability values. Variation in the methods and assumptions in the determination of assets and liabilities has the potential to significantly affect the relative strength of capital positions of otherwise similar insurers. Applying a common set of capital requirements could produce different views of insurer strength for each accounting system used due to the ways in which the accounting systems can define liability and asset values. These definitions thus could create a hidden surplus or deficit.”

### **Total balance sheet approach**

The need for total balance sheet approach is not brought out clearly. Hence add the following after the third bullet point appearing on page 5, before paragraph 16:

“Hence in choosing a capital requirement or in comparing capital amounts between insurers, it is necessary to take into account the methods and assumptions used to determine all the components of the balance sheet including actuarial reserves. This requires appraisal of its total balance sheet on an integrated basis under a system that depends upon realistic values and consistent treatment of both assets and liabilities. Such treatment does not generate hidden surplus or deficit.”

### **Reinsurance**

In the paper, there is no reference to reinsurance. The role of reinsurance while assessing capital requirements cannot be belittled. To address this, add a new paragraph after paragraph 19:

“Both primary insurers and supervisors look for comfort with respect to the financial strength of reinsurance companies who reinsure local business. But from the risk mitigation viewpoint, reinsurance is an international business. Hence to prevent the arbitrage of capital between insurers and reinsurers operating in different jurisdictions, it is important to have a set of internationally consistent financial standards of reinsurers’ financial strength. In assessing the capital position of insurers this aspect deserves due attention.”

### **Time horizon**

In the same manner, the importance of time horizon is to be recognized, but there is no mention of this. Add the following as a new paragraph after the present paragraph 20:

“The degree of protection afforded by a set of capital requirements is dependent on the time horizon considered. Since this time horizon depends upon local business practices, the supervisors’ resources, legislation and legal system, this horizon will vary from one jurisdiction to another. However, while positioning appropriate supervisory standards on suitable forms of capital, this time horizon is to be duly recognized.”

**Paragraph 30**

Add the following: “The classification of a capital instrument should be based on its real nature and not on its title.”

**Concluding remarks**

The Solvency Subcommittee is grateful for the opportunity to comment on this draft and we are available to elaborate on any of the points raised above.

## *Appendix*

### **Full Member Associations of the IAA**

Consejo Profesional de Ciencias Económicas de la Ciudad Autónoma de Buenos Aires  
(Argentina)  
Institute of Actuaries of Australia (Australia)  
Aktuarvereinigung Österreichs (AVÖ) (Austria)  
Association Royale des Actuaire Belges (Belgique)  
Instituto Brasileiro de Atuária (IBA) (Brazil)  
Canadian Institute of Actuaries/Institut Canadien des Actuaire (Canada)  
Cyprus Association of Actuaries (Cyprus)  
Česká Společnost Aktuárů (Czech Republic)  
Den Danske Aktuarforening (Denmark)  
Egyptian Society of Actuaries (Egypt)  
Eesti Aktuaaride Liit (Estonia)  
Suomen Aktuaariyhdistys (Finland)  
Institut des Actuaire (France)  
Deutsche Aktuarvereinigung e. V. (DAV) (Germany)  
Hellenic Actuarial Society (Greece)  
Actuarial Society of Hong Kong (Hong Kong)  
Magyar Aktuárius Társaság (Hungary)  
Félag Íslenskra Tryggingastærðfræðinga (Iceland)  
Actuarial Society of India (India)  
Society of Actuaries in Ireland (Ireland)  
Israel Association of Actuaries (Israel)  
Istituto Italiano degli Attuari (Italy)  
Institute of Actuaries of Japan (Japan)  
Japanese Society of Certified Pension Actuaries (Japan)  
Latvijas Aktuaru Asociācija (Latvia)  
Lebanese Association of Actuaries (Lebanon)  
Persatuan Aktuari Malaysia (Malaysia)  
Colegio Nacional de Actuarios A. C. (Mexico)  
Het Actuarieel Genootschap (Netherlands)  
New Zealand Society of Actuaries (New Zealand)  
Den Norske Aktuarforening (Norway)  
Actuarial Society of the Philippines (Philippines)  
Polskie Stowarzyszenie Aktuaruszy (Poland)  
Instituto dos Actuários Portugueses (Portugal)  
Academia de Actuarios de Puerto Rico (Puerto Rico)  
Singapore Actuarial Society (Singapore)  
Slovensko Aktuarsko Drustvo (Slovenia)  
Actuarial Society of South Africa (South Africa)  
Col.legi d'Actuaris de Catalunya (Spain)  
Instituto de Actuarios Españoles (Spain)  
Svenska Aktuarieföreningen (Sweden)  
Association Suisse des Actuaire (Switzerland)

Actuarial Institute of the Republic of China (Taipei R.O.C.)  
Faculty of Actuaries (United Kingdom)  
Institute of Actuaries (United Kingdom)  
American Academy of Actuaries (United States)  
American Society of Pension Actuaries (United States)  
Casualty Actuarial Society (United States)  
Conference of Consulting Actuaries (United States)  
Society of Actuaries (United States)