



**ASSOCIATION ACTUARIELLE INTERNATIONALE
INTERNATIONAL ACTUARIAL ASSOCIATION**

September 22, 2003

Mr. Giovanni Manghetti
Chairman, Task Force on the Revisions
to the Insurance Core Principles and Methodology
International Association of Insurance Supervisors
c/o Bank for International Settlements
CH-4002 Basel, Switzerland
Email: sez.internazionale@isvap.it

Dear Mr. Manghetti,

Re: Insurance Core Principles and Methodology

Further to my letter to you of May 26, 2003 forwarding the International Actuarial Association's (IAA) draft comments on the draft revision to Insurance Core Principles and Methodology, I am pleased to confirm that the IAA's due process is now complete. The draft comments were approved by the Full Member associations for release as an IAA public statement, subject to certain revisions which are incorporated in the attached submission.

A copy of the final document is enclosed for your files.

Sincerely,

W. James MacGinnitie
President

Attachment

cc: Mrs. Jane Lamb (Email: Jane.Lamb@bis.org)
Mr. Alberto Corinti (Email: alberto.corinti@isvap.it)
Mr. Jukka Rantala (Email: Jukka.Rantala@etk.fi)

A Commentary on the Draft Revision to the Insurance Core Principles and Methodology

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 a committee of the IAA, the members of which are listed below by name and association. These comments which were circulated for approval to the Full Member associations of the IAA as part of our due process procedures have been approved as a public statement of the IAA.

Members of the IAA Insurance Regulation Committee

Jukka Rantala	Chairman
David Hartman	Co-Vice-Chairman
David Sandberg	Co-Vice-Chairman
Félix Arias Bergadà	Col.Legi d'Actuaris de Catalunya
Andrew John Michael Chamberlain	Institute of Actuaries
Isagani de Castro	Actuarial Society of the Philippines
Nelson Emiliano Costa	Instituto Brasileiro de Actuária
Joubert Ferreira	Actuarial Society of South Africa
Rainer Fürhaupter	Deutsche Aktuarvereinigung e. V. (DAV)
K.S. Gopalakrishnan	Actuarial Society of India
Gyula Horvath	Hungarian Actuarial Society
Thomas Karp	Institute of Actuaries of Australia
Toshihiro Kawano	Institute of Actuaries of Japan
Jean-Michel Kupper	Association Royale des Actuaire Belges
Won How Lo	Actuarial Institute of the Republic of China
Helge-Ivar Magnussen	Den Norske Aktuarforening
Dina Mikelsone	Latvijas Aktuaru Asociacija
Bruce Maxwell	Society of Actuaries in Ireland
Ibrahim Muhanna	Cyprus Association of Actuaries, Lebanese Association of Actuaries
Ryoichi Nakamura	Institute of Actuaries of Japan
Gennaro Olivieri	Istituto Italiano degli Attuari
Ian Perera	New Zealand Society of Actuaries
Thierry Poincelin	Institut des Actuaire
Angus John Robertson	Faculty of Actuaries
Norma Alicia Rosas	Colegio Nacional de Actuarios A.C.

Simon Van Vuure
Robert E Wilcox

Het Actuariel Genootschap
Society of Actuaries; Conference of Consulting Actuaries

IAA Comments

The Insurance Regulation Committee of the International Actuarial Association has reviewed the January 31, 2003 draft of the captioned paper and offers the following comments.

General remarks

The actuarial profession believes that increasing the detail underpinning the interpretation of the core principles is a vital step in bringing together the national standards for prudential provision. Inevitably, further detail will result in certain practices being less acceptable in the future. However, this can be made to work provided that the overall outcome is a raising of standards.

One area where further detail and consequent raising of standards might have been possible, but was not addressed, was the granting of options and guarantees, both financial and insurance. A more direct discussion of this important issue in a number of core principles would accelerate the introduction of better regulation at a national level and would directly address one of the major challenges to international financial stability.

One element of the proper pricing of options and guarantees is often overlooked. The revised core principles describe in the Introduction the impact that social change has on the insurance industry. An aspect of this is the role that politicians place on insurers as instruments of social policy. For example, insurers are widely used as an important plank in the provision of income in retirement. The downside of this important role is that politicians will not necessarily recognize the economic cost of measures that are otherwise popular with the saving public. The granting of expensive performance guarantees as part of tier 2 pensions is an example. The requirement by supervisors on insurers to recognize such costs would ensure that a proper debate of the desirability of different policy options is undertaken.

Specific remarks

ICP 1, criterion c.

We support the need for an effective legal system. We also feel it would be useful to underline the importance of the stability of the legal principles over time. The development of consumer law and the continuing process of re-interpretation of contract law through judicial systems, sometimes with retrospective impacts, risks damaging the long-term viability of insurance and consequently its availability. We note in the same context the comments made in paragraph 36 under ICP 8.

ICP 1, criterion e.

This paragraph appears to link ICP's to the future IASB standards, and care is needed that they will be consistent with these principles. We endorse the need for strong accounting standards internationally but would highlight that not all internationally accepted accounting standards

necessarily reflect the underlying economic position of the insurer. We would suggest that the principle be re-drafted to make clear that the criterion depends on the standard reflecting the proper evaluation of the insurer's financial condition.

ICP 1, criterion f.

This paragraph says that accountants, auditors and actuaries need to be "independent". It is possible to interpret this as saying that an insurer should not hire its own full-time accountants or actuaries, but must instead rely on independent consultants for this work. We assume that this is not the intention of this criterion. We would recommend that the criterion is reworded to emphasize that objectivity rather than independence is the crucial element.

ICP 1, criterion i.

As might be imagined, the IAA strongly endorses this criterion. The IAA will continue to promote the implementation of strong professional standards for actuaries across national jurisdictions.

ICP 1, criterion j.

This criterion states, "a stable environment, supported by sound macro-economic policies, exists for the operations of insurance sector".

The environment should not only be stable, but also conducive to a stable insurance sector. For example, insurers should have sufficient scope for sound underwriting and pricing. Where legal or cultural circumstances constrain underwriting and pricing, then the regulator should seek to support the insurers, through publicity of the ensuing distortion of the resulting insurance market, to promote a freer underwriting and pricing regime.

ICP 3, criterion j.

The principle of consultation is undermined unless regulations and practices introduced to address urgent issues are not subject to subsequent review. We suggest that regulations and practices introduced rapidly in response to urgent situations always be subject to fixed time limits after which period they lapse unless endorsed through due process.

ICP 3, criterion o.

Supervisors need not only power to act immediately but also to act preventatively, that is in advance of recognized problems breaking statutory rules.

ICP 6, criterion b.

It would be useful to clarify that a license should only be granted if the board, management, auditor and actuary are suitable both individually and collectively. This point is made in a later ICP [ICP 9, criterion i] but it is worth emphasizing that this is best achieved at the licensing stage of supervision.

It might also be useful at this point in the paper to stress the importance of a balance of directors with an independent ('non-executive') perspective in order to avoid the risk that an individual or small group of directors can become over-dominant.

Paragraph 32

As might be expected, we welcome the support of supervisory authorities in recognizing actuarial standards and we invite the IAIS to make specific reference to the IAA's standards of professional conduct, competence and discipline that are required as a precondition of membership for actuarial associations.

ICP 7, criterion f.

We endorse the need to avoid any material conflict in the roles undertaken within management and the board. However, the example provided is not the most useful since many jurisdictions do not have 'appointed actuaries' and would not recognize the point being made. Further, even in those territories with 'appointed actuaries' or 'responsible actuaries', the roles differ markedly and in many territories the senior actuary on the board could at the same time perform a senior executive role without any conflict, real or perceived. A different example might be more appropriate. For example, one would expect it to be inappropriate for the 'appointed actuary' to also serve as 'chief financial officer' or 'chief executive officer'.

Paragraph 36

Reference should also be made to the demutualization of mutual insurers here and also in the subsequent "Essential criteria".

ICP 8, criteria a and b.

In all cases (change of control, transfer, mutualization, demutualization, merging) the interests of policyholders have to be protected.

ICP 9, criterion d.

It is not clear whether the IAIS is advocating the use of external actuarial review in the same manner as the audit is external. When it states in the last sentence, "The board of directors establishes external-audit functions and actuarial functions ...", can this be met through the use of the auditor's actuaries used as part of the external auditor's evaluation of the financial statements? It would be helpful if this particular criterion were clarified.

ICP 10, criterion c.

Is the intent of this criterion to extend the role of the auditor or the external actuary to the certification of the quality of internal controls? We understand that this would be a significant extension of the external opinion given in many territories and consequently could dramatically increase the costs to insurers of external audit. The IAIS should assure itself that the costs of this extension are justified by the benefits.

ICP 10, criterion e.

The actuarial profession plays a major role in the fair treatment of policyholders, including in many aspects of insurance operations now regarded as market conduct activities. The actuarial profession would see the monitoring of internal controls described in criterion c above as including market conduct activities. Does the IAIS view this in the same way?

ICP 10, criterion k.

It would be helpful if this reference to actuarial reporting could be clarified, as it seems somewhat circular at present.

ICP 12, criterion g.

We suggest that the (appointed) actuary should sign off on information, where appropriate.

Paragraph 51

"On-site inspection ... provides information that supplements the analysis of the financial and statistical information sent by the insurer".

We suggest including technical and actuarial information, among others.

ICP 13, criterion b.

We consider that a full-scale on-site inspection has to consider the "analysis of the sufficiency of the technical provisions" or the "valuation of the technical reserves". We note that this requirement is included in criterion d of ICP 20.

ICP 15, criterion d.

We feel that it is unlikely that a regulator can require capital levels to be increased from sources external to the regulated entity and that the regulator should aim to meet any foreseeable future capital requirements from the current resources of the regulated entity.

ICP 16, criterion b.

Experience suggests that the insolvency regulations should allow for the run-off of existing policies rather than the immediate break-up, as the latter is expensive and does not allow policyholders a means to achieve an orderly transfer of cover to another carrier.

ICP 19, criteria c and d.

These paragraphs require the regulator to exercise some control over pricing. Though it may be useful for the regulator to obtain information in this area, we suggest that by far the most effective way to ensure control is to require that the insurer have a clearly defined procedure and control mechanism for setting premiums. A requirement to have actuarial control of pricing would be extremely useful for ensuring the adequacy of premiums. The description of supervisory responsibilities with regard to checking how insurers set premiums seems extremely detailed for a financial review. If there is no actuarial involvement, can this be met through the use of monitoring financial results, with no detailed inspection required if financial results are satisfactory?

These criteria seem to require the regulator to focus on details when reviewing the underwriting function, but focus on strategic issues only when reviewing the investment function.

Paragraph 74

In the third sentence the need for "an appropriate degree of prudence in the technical provision ...", is mentioned. It should be recognized that such prudence could be reflected either in the liabilities or in the capital requirements. If the financial statements are filed according to IAS, and IAS rules do not allow sufficiently "prudent" provisions for supervisory purposes, then supervisors may find themselves failing this criterion through no fault of their own. This would happen even if the supervisory system adequately adjusted for the liability accounting rules

through more stringent capital requirements. We recommend that the wording be revised to recognize the need for reflection in either the technical provisions or the capital requirements.

Also, in the third sentence, "the standards should ensure an appropriate degree of prudence in the technical provisions' (liabilities) recognition and measurement, make use of reliable and objective methods", the degree of conservatism in the assumptions should be considered.

We suggest dropping the phrase "particularly in the case of life insurance" at the end of this paragraph.

ICP 20, criteria b and c.

We suggest these standards be developed in collaboration with the local actuarial association.

ICP 20, criterion c, third bullet point

This paragraph says policy liabilities "at all times should be such that the insurer can meet any liabilities arising out of insurance contracts as they fall due". This seems to be going beyond the definition of a liability and into the definition of capital or solvency margin. The liabilities are supposed to cover expected losses and a limited margin for risk. Capital is needed above those amounts to cover further deviations from expectations. We recommend deleting this wording.

ICP 20, criterion g.

The actuarial profession regards a base level of stress testing and other basic forms of investigation of prospective solvency as essential rather than an advanced requirement and suggests that this criterion be included as an essential criterion. The same comment applies to ICP 21, criterion j and ICP 23, criterion j. The advanced category would then require the use of a range of modern risk and solvency assessment techniques.

ICP 20, criterion d.

This paragraph requires the regulator to exercise some control over reserving. Though it may be useful for the regulator to obtain information in this area, we suggest that by far the most effective way to ensure control is to require an actuary to sign off on this issue.

ICP 21, criteria a and i.

A major risk facing the long term insurance industry is that the reinvestment rate will be below the technical rate for many plans where the current outstanding term of the liabilities significantly exceeds the outstanding term of the assets. Given the importance of this risk, we believe that this should be addressed specifically.

Though it may be useful for the regulator to obtain information in this area and on asset/liability management generally, we suggest that by far the most effective way to ensure control is to require an actuary to give a statement on the investment plan; especially how the planned investments match with the liabilities.

ICP 22

The actuarial profession acknowledges the risks posed by the inappropriate management of derivatives but also would have liked to have seen a greater recognition of the onerous financial

options embedded in existing policy liabilities and the useful role that certain derivatives can play in managing these existing risks.

Should there be an ICP similar to ICP 22 dealing with hedge funds?

ICP 23, criterion a.

We suggest consideration of reinsurance operations, because the effectiveness of the risk transfer and the security of the reinsurer might affect the capital adequacy and solvency requirements.

ICP 23, criterion f.

This paragraph reads "Capital adequacy requirements are established at a level such that an insurer having assets equal to the total of liabilities and required capital will be able to absorb the unforeseen losses that can occur".

If one has to comply with the above, it will require virtually unlimited capital. The required capital can never be set at a level that eliminates all chance of loss.

In the IAIS' Principles on Capital Adequacy & Solvency, approved in Tokyo on 9 January 2002, paragraph 3 establishes that an insurance company is solvent if it is able to fulfil its obligations under all contracts under all "reasonably" foreseeable circumstances. Therefore, we suggest the wording "will be able to absorb the unforeseen losses than can occur" be changed to "be set at a level that reduces the amount of losses to an acceptable level."

We note that the IAA has established a working party to prepare a proposal for a framework for assessing the capital adequacy of insurers. The report of the working party will include a comprehensive discussion on various risk measures, time horizons and confidence levels to be used in solvency assessment. We hope that the report will be useful to the IAIS, when setting standards related to the prudence of the capital of insurers.

ICP 23, criterion j.

The projection of the solvency position of an insurer requires a significant input from the actuarial profession if it is to provide a coherent view of the future. We suggest that this point is included.

ICP 25, criterion d.

This criterion suggests that supervisors should require disclosure of estimated returns. As recent financial performance has illustrated, the estimation of future returns can lead to policyholders becoming over-reliant in their personal financial planning on such projections. This is a difficult area and flexibility of practice dependent on the sophistication of the insuring public might be advisable until more robust methods are established.

Paragraph 94

It is essential that the IAIS and the IASB coordinate the disclosure requirements for insurers as each organization is proposing significant increases in published information that will be costly and possibly counterproductive for the reader.

Paragraph 96

We think it would be appropriate to add in this paragraph that actuaries can provide help in the detection of fraud through the use of statistical methods.

Detailed remarks

Paragraph 15

This paragraph reads "Overall, the effectiveness of insurance supervision is a function of the overall industry environment, the equality of the essential conditions, and the ability of the supervisor to apply the core principles taking cognizance of its capacity, competence, internal controls, integrity of operations, and independence."

We do not understand the use of the word "equality" in the second line. Should it have been "quality" or "presence"?

ICP 1, criterion g.

How is the term "social statistics" defined? Such statistics are not typically part of insurance supervision.

Paragraph 30

There is a typo here. Should the word "meets" be changed to "meeting"?

ICP 7, criterion g.

A typo. It should read "Where the insurer becomes aware ...".

Concluding remarks

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

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 Islenskra 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)
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 (Taiwan 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)