



**ASSOCIATION ACTUARIELLE INTERNATIONALE
INTERNATIONAL ACTUARIAL ASSOCIATION**

September 30, 2003

Mr. Yoshihiro Kawai
Secretary General
International Association of Insurance Supervisors
c/o Bank for International Settlements
CH-4002 Basel, Switzerland
Email: yoshihiro.kawai@bis.org

Dear Mr. Kawai,

Re: Standard on Disclosures Concerning Technical Performance and Risks for Non-Life Insurers and Reinsurers

Further to my letter to your predecessor of May 20, 2003 forwarding the International Actuarial Association's (IAA) draft comments on the Draft Standard on Disclosures Concerning Technical Performance and Risks for Non-Life Insurers and Reinsurers, I am pleased to confirm that the IAA's due process is now complete. The draft comments, as submitted, have been approved by the Full Member associations for release as an IAA public statement.

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

Sincerely,

W. James MacGinnitie
President

Attachment

cc: Jane Lamb (Email: Jane.Lamb@bis.org)
Lonny McPherson (Email: lonny.mcpherson@bis.org)
Hele Gade (Email: hg@ftnet.dk)
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**A Commentary on the
DRAFT STANDARD ON DISCLOSURES CONCERNING TECHNICAL
PERFORMANCE AND RISKS FOR NON-LIFE INSURERS AND REINSURERS
Released by the International Association of Insurance Supervisors: March 2003**

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
Morris Chambers	Canadian Institute of Actuaries/Institut Canadien des Actuaire
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
Gennaro Olivieri	Istituto Italiano degli Attuari
Ian Perera	New Zealand Society of Actuaries
Thierry Poincelin	Institut des Actuaire

Angus John Robertson
Norma Alicia Rosas
Simon Van Vuure
Robert E Wilcox

Faculty of Actuaries
Colegio Nacional de Actuarios A.C.
Het Actuarieel Genootschap
Society of Actuaries; Conference of Consulting Actuaries

IAA Comments

The Insurance Regulation Committee of the International Actuarial Association has reviewed the March 13, 2003 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. Disclosures of insurers' financial performance and position are critical to the working of proactive supervision, risk management and market discipline as envisaged in the ICP's, mirroring the Basel II proposals. Effective supervision and market feedback cannot operate without such information.

Overall, we believe that the IAIS has identified essentially all the major problem areas for disclosure and we agree with the general direction of the proposed disclosures, but believe that significant adjustments are required in some areas to make them effective. In particular, we believe that:

- Disclosures net of reinsurance are of equal importance to those that are gross of reinsurance.
- Greater consideration is required for the proper reporting of discounting, especially in the context of claim development and technical provision runoff. When reporting on such development or runoff, any reporting of investment performance should be separate and distinct from reporting of the runoff or development of technical provisions.
- Wherever possible the required disclosures should be in a standardized format. This would facilitate electronic reporting of such information, increasing the accessibility of the data and making it possible to analyze large amounts of information in an efficient manner from multiple insurers. (Note that the standardized format should probably vary by country to reflect product and market differences by country.)
- Disclosures of risk and uncertainty should focus on key risk factors, and should not require the listing of assumptions and models that are not key risk factors. In addition, key risk factors from non-life insurance liabilities are unlikely to be easily standardized¹. Hence, standard formats or pre-defined required lists should be avoided in this area. Reliance should be placed instead on requiring an insurer to disclose its own particular sources of risk and uncertainty.

The IAA wants to stress that the International Accounting Standard Board (IASB) is drafting International Financial Reporting Standards (IFRS) on insurance contracts. These standards are expected to become widely accepted as the basis of the financial reporting of insurance companies. The IAA has set up its own working groups to liaise with the IASB in developing the standards. The IASB standards will also include guidelines for disclosure. Since different

¹ This is in contrast to the situation with insurer's assets, where the risks associated with invested assets are likely to be very similar across different types of non-life insurers and with non-insurers from different countries.

standards for disclosing similar items would easily make the interpretation of the disclosures confusing rather than facilitating, the IAA strongly desires that the IAIS standards will be made compatible with the forthcoming IASB standards as soon as the latter are available.

The following are our detailed comments.

Page 5-6, paragraphs 5-13 – Pricing Adequacy

While we agree with the four performance measures listed in paragraph 5, we note that they are based on a deferral-matching accounting system. This may be inconsistent with the final IASB proposal for insurance accounting, which appears to favor an asset-liability approach over deferral-matching. In particular, premium revenue based on an earned premium concept would no longer exist under the proposed asset-liability approach. It is unclear whether the IAIS would want insurers to maintain two sets of books in such a situation (one based on deferral-matching and one based on asset-liability) or whether the disclosures would have to change to reflect the new premium revenue measure (which would be written premium under an asset-liability approach).

Note that further paragraphs also reference the term “earned premium”.

Page 5, paragraph 6 – Gross of reinsurance issue

We agree that pricing adequacy disclosures on a gross of reinsurance basis are important. But we feel that such disclosures on a net of reinsurance basis are equally or even more important. This is especially true for products sold to large corporations, as the risk-sharing with the insured can be accomplished via reinsurance to a captive, attaching only on an excess basis, large deductibles, or through retrospective premium arrangements. Performance measures on a gross of reinsurance basis would be distorted based on which of these product options was chosen, while net of reinsurance measures would be minimally impacted. In addition, some residual market mechanisms in certain jurisdictions are currently accounted for as reinsurance transactions. In these instances, performance measures on a gross of reinsurance basis can significantly distort the real underwriting risk these companies face, while measures on a net of reinsurance basis provide a much more reliable and relevant measure of the insurer’s underwriting risk. Therefore, if only one way of presentation is chosen in order to limit the number of disclosures, we would recommend that a net of reinsurance basis with a summary disclosure of ceded reinsurance be elected.

Page 5, paragraph 6 – Calendar year versus accident or underwriting year

This paragraph proposes that these measures should be calculated on an accident or underwriting year, but apparently not on a calendar year. Both calendar year and accident/underwriting year measures provide useful information and both are required for a full understanding of underwriting results and their impact on year-end capital. Are there plans to require any ratio disclosures concerning underwriting profitability on a calendar year basis that would incorporate both the current accident/underwriting year and changes in estimate of prior years?

Page 5, paragraph 8 – Expense ratio

The expense ratio definition defines the denominator to be on a deferral-matching basis, but is silent on how the numerator (expenses) is determined. Both the numerator and denominator should be calculated on consistent accounting bases. If the denominator is to be earned premium, then the numerator should be calculated in a way that allows for deferred expenses. If the denominator is changed to written premium, then the numerator should be based on an asset-liability approach.

Page 5, paragraph 9 – Combined ratio

The statement that insurers can be profitable even with combined ratios over 100% assumes that the loss ratio will be calculated on an undiscounted basis. This was not clear in the definition of loss ratio given earlier. Either the definition of loss ratio should clearly be defined as being on an undiscounted basis, or the statement about combined ratios over 100% should be qualified. (Note that a similar issue exists in paragraph 13.)

The discussion about the combined ratio in the bottom half of this paragraph is about interpreting a combined ratio relative to an insurer's profitability. But the exact wording implies that it is a discussion of a combined ratio's calculation and not its interpretation. The combined ratio is not affected by investment income or uncertainty for a line, but the profitability underlying a certain combined ratio is affected by these things. The wording should be changed in the last two sentences to fix this, replacing the words "combined ratio" with "profitability underlying a certain combined ratio".

Page 6, paragraph 10, Operating ratio

The definition of operating ratio appears to vary by country. The definition given in paragraph 10 is the sum of losses and expenses, all divided by the sum of premiums and investment income. This is in contrast with the definition used in the United States (and included in the NAIC's "IRIS" ratios and in the Casualty Actuarial Society textbook), which is the combined ratio less the ratio of investment income to earned premium. Given that the IRIS ratios in the United States are used as part of an early warning system, any change in the definition may affect the point where increased supervisory scrutiny occurs. Therefore, we recommend that the IAIS members determine whether or not they want to standardize the definition of operating ratio across their membership, and if so, which definition to choose.

Page 6, paragraph 11, Discounting

This paragraph does not describe how one should incorporate discounting when reporting the loss ratio, and whether discounting should be reflected in reporting the expense ratio. Loss ratios for accident or underwriting years that reflect discounting should discount the losses back to the average date of the premiums. In general, this could be either the middle of the accident/underwriting year or beginning of that year. The choice of these two dates is not as important as the need for a consistent choice across years, products and insurers included in the reporting.

Relative to expense discounting, this can be an issue for long-term contracts or jurisdictions in hyper-inflation environments. For example, if an insurer sells 3 year contracts and reports on an underwriting year basis, the expense flows could extend for 3 (or more) years beyond the premium collection. More guidance is needed in this area to ensure consistent reporting.

This paragraph is silent as to the determinant of whether these ratios should be discounted. If this decision is made on an insurer-by-insurer basis, country-by-country and line-by-line, then no comparability would exist. The IAIS may be better served by requiring standard reporting approaches for certain products in certain jurisdictions relative to discounting. When doing so, we recommend that the IAIS strive to maintain consistency with whatever IASB disclosure requirements exist. The IAIS may also want to consider the impact of any proposed discounting approach on both accident/underwriting year and calendar year loss ratios, as discounting can impact them in totally different ways.²

The bullet points require the disclosure and analysis of discount by year for the next 5 years, then for all later years on a combined basis. This may be acceptable for disclosure, but insurers should not be so constrained in their analysis. We recommend deletion of the phrase “and analyzed”.

Page 6, paragraph 13, Combined ratio interpretation

The last sentence of this paragraph assumes that the combined ratios are based on undiscounted losses. This should be stated explicitly.

Page 6, paragraph 15, editorial

The first sentence may be more readable if it were reworded as follows:

“To facilitate the evaluation of an insurer’s ability to assess ...”

Page 7, paragraph 18, Runoff of provisions for future losses, second bullet

This bullet may be interpreted as applying only to unearned premiums that are earned in the following year. But some contracts have unexpired terms longer than one year. This confusion could be eliminated by replacing the wording:

“relating to claims incurred during the period covered by the unearned premiums at the beginning of the year.”

with

“relating to insurance events covered by the unearned premiums at the beginning of the year.”

² An accident year loss ratio on a discounted basis will always be less than the loss ratio on an undiscounted basis (excluding the possible impact of subrogation and salvage). But a calendar year loss ratio calculated using discounted claim liabilities may be greater than or less than the same ratio calculated on an undiscounted basis, depending on whether the undiscounted claim liabilities are growing or shrinking.

Page 7, paragraph 19, Treatment of discounting when reporting runoff of provisions

When reporting provision runoff data, this paragraph says:

“When discounting is used, insurers should take account of it by including the return on investments reserved for the losses in question.”

We see several problems with this suggested approach. First, the reporting of actual investment returns in provision runoff data may reflect on the strength of the investment portfolio (and investment management) more than it reflects the accuracy of the original technical provisions. Second, non-life insurers typically have very limited segmentation of their investment portfolios such that the return on investments reserved for specific losses is not directly available. Instead, any inclusion of investment returns in runoff data requires an arbitrary allocation. Third, any such allocation can be distorted by sales of investments for tax or liquidity purposes (such as in the event of a large natural or man-made catastrophe).

We recommend instead trying to isolate investment results from the runoff of technical provisions. One way of accomplishing this is to require reporting of technical provision runoff on an undiscounted basis, even if the underlying technical provisions are discounted for the time value of money. This tests the accuracy of estimates of ultimate payout, but not the accuracy of estimates of payout timing. A second way is to require reporting of payouts discounted back to a set time, using uniform rules for discount rates across the industry. For example, required discount rates could be published by the supervisory authority for the current or next accident/underwriting year, based on the latest yield curve for risk-free or low credit risk bonds (with a possible additional adjustment to reflect risk). These rates would be locked-in for future reporting of the accident/underwriting year runoff.

Perhaps the best way to monitor provisions for incurred claims and also discounting would be to require reporting of three data triangles:

- Incurred claim estimates by accident/underwriting year by valuation date,
- Paid claim amounts by accident/underwriting year by valuation date, and
- Discount included in the technical provisions by accident/underwriting year by valuation date.

With these three data triangles the user should have sufficient information in most cases to do at least a preliminary analysis regarding adequacy of technical provisions on both an undiscounted and discounted basis³.

Page 7, paragraph 21, overlap with paragraph 17

There is significant overlap between paragraph 17 and 21, such that the information provided under paragraph 21 could be used to independently create the data required for paragraph 17. In fact, in many (most?) cases the detail required in paragraph 21 is necessary to properly evaluate the runoff reported under paragraph 17. Is there a reason why both should be required, as opposed to dropping paragraph 17?

³ This recommended approach would require three different runoff triangles. Given the volume of paper and information that results, the IAIS may choose to limit such reporting to a total company basis, or require the reporting of runoff triangles on a more summarized basis (with regard to product/line/class) than used for reporting premiums and losses.

Page 8, example at top of page

Should the line labeled “ultimo accident year” be changed to “at end of accident year”?

As mentioned earlier in our comments regarding paragraph 19, discounting can also be handled by reporting the values in the table at their present value, discounted back to the beginning or middle of the accident year. The disadvantage of the approach in this example is that it provides no runoff test of the cashflow timing assumptions underlying the discounted values. Whichever approach is used, the most important consideration may be consistency across insurers, products and years.

Page 8, paragraph 22, gross versus net of reinsurance reporting

As mentioned earlier in our comments on paragraph 6, there are disadvantages to the reporting of data on a gross basis, only.

An additional disadvantage relative to some insurance groups is the existence of quota share reinsurance agreements among members of the group. In these arrangements, it is common for all quota share “pool” participants to cede all their losses to one member of the pool (the “flagship”), which then cedes back set percentages of the total pooled results to all pool members. Any external reinsurance is typically processed and reported only by this flagship, such that all cedes to the flagship are done gross of external (to the pool) reinsurance and all cedes back down to pool members are net of all external reinsurance. When these arrangements exist, the solvency of the pool member is a function of technical provision adequacy for the entire pool, not just for one pool member on a gross basis. Gross data for a pool member can also be expensive to produce and largely irrelevant to an analysis of the pool member’s solvency.

The approach to this pooling issue in at least one jurisdiction is to require pool members to report their claim development by applying their quota share pool percentage to the total pool claim development triangle.

Pages 7-8, Paid runoff

Paragraph 21 requires the reporting of incurred claim development, but only incidentally mentions paid runoff. The IAIS should include a requirement to report paid development as well. (Note that this comment has already been made with respect to discounting, although this disclosure should be required whether or not an insurer discounts its technical provisions for the time value of money.)

Pages 6-8, Runoff Triangles and Claim Development, disclosure of distortions

Somewhere in the Provisions Adequacy section where runoff triangles and claims development schedules are discussed, there should be a requirement to disclose distortions to such history. A major purpose of such historical disclosures is to allow the user to make judgments on current technical provision adequacy. Such analysis would be inaccurate if there were material

distortions in the historical data that were not disclosed. The analysis would also be flawed if there were valid reasons why future runoff or development would not be expected to follow past trends. We recommend that disclosure be required if future development is not expected to follow past trends, whether due to a change in business mix, change in claim practices, or a distortion in the past (such as a major catastrophe or large liability loss).

Page 8, Claim statistics

The discussion in paragraphs 23 and 24 place too much emphasis and reliance on the usefulness of claim count information. Claim counts (and the resulting statistics such as average claim values, claim frequency and claim development) can be useful information for some products and lines, but they are not universally useful. Problems with such data include:

- They are generally unavailable from business written on a pro-rata assumed reinsurance basis. With such business, the underlying cedant typically reports only the paid and incurred amounts subject to the treaty, and not the claim counts. Even if reported, such counts have an unclear definition where the reinsurance is for less than 100% of the underlying losses, especially if the percentage reinsurance varies by contract. For example, if a reinsurer assumes 20% of the losses from insurer A and 40% of the losses from insurer B, how should any of the underlying claim counts be reported? Should the reinsurer claim counts equal the total of insurer A's plus insurer B's counts? Should the reinsurer claim counts equal 20% of A's plus 40% of B's counts?
- They are only useful if the underlying data is homogeneous relative to the exposure from a single claim. There are many product lines where the individual policies do not contain homogeneous levels of exposure per claim. Consider for example one claim against a large international company on a policy with US\$10 million in limits, versus another claim against a small business owner on a policy with US\$50,000 in limits. Adding the claim counts together and calculating average values produces additional data but no additional information. Claim count data is only useful if the underlying claims are homogeneous.
- Liability policy deductibles and reinsurance arrangements distort their usefulness. Consider a group of claims from liability policies with US\$500,000 in limits and no deductible versus a group of claim from liability policies with US\$1,000,000 in limits but with a US\$900,000 deductible. (Note that such "large deductible" policies typically require the insurer to pay the full claim, then bill the insured for the deductible.) How should the underlying claims be counted? Should only the claims above the deductible be counted? Should all claims be counted, even if currently estimated to be wholly under the deductible maximum? If the latter, average values would be severely distorted due to the large number of claims with "zero" values.
- Claim counts are not defined (or definable) consistently across products or even claims for the same product. For example, how many claims would be recorded from one class action lawsuit, reportedly representing a stated 100,000 unnamed (and currently unidentified) individuals, versus the claims recorded from one lawsuit from the head of a family (involving injuries to multiple party members and their property), versus a simple "slip-and-fall" claim from one injured party. Other problems include claims against first dollar policies versus high level aggregate excess policies, and claims for reimbursement by an insured for multiple current and future claims being made directly against it (and being administratively handled directly by the insured).

In summary, while claim data may be useful for certain products, it is not universally useful. Requirements to report claim count data should be limited to those instances where it is generally homogeneous and consistently defined, such as motor vehicle policies sold to individuals.

Where such claim count data is reported, the resulting statistics should not have to be reported to the extent they are directly calculable from other disclosed data. Such calculations should be left up to the user of the information, and made easier by a requirement to electronically submit such information in standard formats.

Page 9, paragraph 28, typo in first sentence

The word “the” should be deleted in the phrase “insurer’s the risk concentrations”.

Page 9, paragraphs 29, 30 – Earned premium reference

Is there any reason why the risk concentration has to be in terms of earned premium? Would a written premium disclosure suffice? While potentially more distorted in the event of policies over 12 months long, written premium may be more readily available.

Page 9, paragraph 29 – marine reference

Later in the paragraph, there is reference to “marine” products, with the implication in the following sentence that marine products always involve ships. This is not always the case, as “marine” insurance policies are sometimes used for any property in transit or with continually varying locations. For example, in the United States, the NAIC defines “inland marine” to be:

“coverage for property that may be in transit, held by a bailee, at a fixed location, a movable good that is often in different locations (e.g., off-road construction equipment), or scheduled property ... including items such as live animals, property with antique or collector’s value, etc.”

This potential ambiguity in the term “marine” can be removed by replacing the phrase “in marine” with “for hull coverage on ocean-going ships”.

Page 10, paragraph 31 – “top-5-cover-concentration ratio”

The calculation of this ratio could be especially problematic for a non-life insurer, due to the fact that many non-life policies do not have a definitive closure date. As past policy periods (accident/underwriting year) remain open indefinitely, this “top-5-cover” concentration ratio conceivably would require analysis of reinsurance policies purchases since the insurer was first formed. Such an analysis would probably serve little useful purpose for users of the disclosed information.

Another concern with the proposed cover ratio is that it would require combining the result of various scenarios of multiple probabilities across multiple product lines. Reinsurance covers for

first-dollar motor policies would be added to those from excess liability policies and those from low frequency-high severity property catastrophe policies.

We suggest that the IAIS instead focus its reinsurance cover disclosure requirements on the distribution of its current reinsurance receivable/recoverable balances by reinsurer. These balances would include amounts billed to reinsurers but currently uncollected, as well as the portion of gross technical provisions currently estimated to be ceded to reinsurers. This should provide a useful distribution of its exposure to reinsurance credit risk for past events, while a similar disclosure based on premium would provide similar exposure information for future events.

Page 10, paragraph 34 – Details of major reinsurance programmes

It is unclear as to what “details” are expected to be disclosed for major reinsurance programmes, or whether this is needed given the disclosures described earlier.

Page 10, paragraph 35 – The cost of reinsurance

We have several difficulties with this paragraph. First, the calculation of the net cost/benefit from reinsurance should include more than just the recoveries collected to-date (including ceding commission). It should include estimated future collectibles on incurred claims. Second, the estimate of the opportunity cost in reduced investment returns is a highly subjective calculation. Such an estimate is best left to the user of the information and not the insurer doing the reporting.

We suggest instead calculating any net cost of reinsurance through the use of measures consistent with those used for reporting gross profitability. These measures were listed in paragraphs 7 through 9, and include the loss ratio, expense ratio and combined ratio. (Note that we do not recommend reporting of a ceded operating ratio, as this would require reporting a hypothetical investment income value. We recommend against required disclosure of hypothetical values.)

Page 11, paragraph 37 – Reinsurance credit risk table

We question whether disclosure of 5 years history for this table is necessary or desirable. Given the rapid pace of change for non-life insurance and reinsurance, we believe that only 2 or so years of history are necessary, including the current year. Data from 5 years ago is frequently too outdated and hence irrelevant for evaluating non-life reinsurer credit risk issues.

Is the term “outstanding” meant to apply only to amounts already billed to reinsurers, as opposed to the estimated ceded portion of the technical provisions. If so, this should be made clearer.

As currently proposed, the table in this paragraph could hide a long-standing collection problem. Amounts billed in past years and still not collected could easily be confused with amounts billed only recently (and not yet collected). We recommend instead requiring an aging schedule, that would show amounts billed but uncollected relative to the time since originally billed. In this

disclosure, allowance should be made for identifying the portion still uncollected that represents a known dispute.

Page 11, paragraph 39 – Disclosure of the form of capital

We would expect that such disclosure would be required for all companies with a form of public ownership. Is the intent to extend the relevant requirement in IAS standards to all insurers, even those privately owned or of a non-profit status, or is the intent to produce capital disclosures above and beyond IAS standards. This should be made clearer.

Page 11, paragraph 40 – Cushion for unexpected losses

The expected profit from the sale of the insurance policy also provides a cushion for unexpected losses. While this may be implicitly understood by the drafters of this proposed standard, it should probably be mentioned explicitly to avoid its omission in evaluating capital needs.

Page 11, paragraph 41 – Leverage ratios

This paragraph requires the disclosure of certain leverage ratios. There are many other leverage ratios that users may desire in addition to or in place of the ones listed in this paragraph. We recommend that the IAIS consider requiring electronic reporting of the raw information for these ratios in standardized formats, so that users may calculate whichever leverage ratios they deem most valuable.

Page 12, paragraph 42 – Segment reporting

This paragraph requires the reporting of the previously discussed items by segment, unless otherwise stated. But the term “segment” is ambiguous and should be defined. This is especially ambiguous given the following discussion of classes or “lines” of business. Are these what are meant by segments? Should the term be defined based on IAS 14?

We also question the required disclosure by segment of all previously discussed items unless otherwise stated. Such an exclusion had not been discussed previously in the proposed disclosure guidance, implying every item discussed so far has to be disclosed by segment. We don't believe the reinsurance credit risk or capital adequacy disclosures should be done by segment, as those items encompass all segments on a combined basis. Rather than requiring segment disclosure on all items unless otherwise stated, we suggest explicitly listing those items that require segment disclosure. We think that this is important, since the amount of disclosure required by the draft standard could easily grow to overwhelming levels (both for the preparer of the disclosures and for the reader). We also recommend that the segment disclosure will be integrated with the forthcoming IASB standards.

Page 12, paragraph 43 – Classes of business

We suggest that this IAIS standard not require a list of classes or lists requiring disclosure. Instead, we suggest a requirement that each local supervisor develop such a standardized list to

be used for all licensed insurers operating in their jurisdiction, with consistency in the list from one year to the next. This would reflect the significant product differences throughout the world, and the inability of any one list to work in all places. Our experience is that even when certain classes share the same label from one country to the next, the underlying differences in product can be substantial. We again refer also to the forthcoming IASB standards.

Page 12-13, paragraph 45 – Key assumptions and sources of measurement uncertainties

We have concerns with the direction this paragraph has taken to deal with the issue of measurement uncertainty. We do not believe a disclosure of assumptions is the best approach for this issue. Instead, we suggest a focused disclosure of the major sources of measurement (and subsequent runoff) uncertainty⁴.

With non-life insurance, the number of assumptions underlying the aggregate technical provisions can overwhelm both the author of the disclosure and the reader. For example, consider the list of products shown in paragraph 43. This is a summary list, such that many insurers will perform their analysis using two to three (or more) times this number of product classes. For each such product class, they may further subdivide the analysis by major market (individuals versus small commercial versus large commercial versus specialty). Each such major market may then be further divided by geographic region, particularly if the insurer sells policies in multiple jurisdictions, each with its own legal system. For each of the resulting subdivisions (which could number over a hundred) a different analysis may be performed, each with its own assumptions. Further, there may be different assumptions for various accident/underwriting year components of these subdivisions. The final collection of assumptions is worthy of a technical appendix for another technical professional to read, but not for the typical user of filed financial statements⁵.

In place of a listing of key assumptions, we recommend required discussion of key risk factors. This would be defined as major sources of risk, including the risk that prices will be inadequate, catastrophes will happen, subsequent runoff will be in excess of current technical provisions, and that ceded reinsurance balances will not be collected. Only those sources of risk material to the financial statement user should be reported on. This should prevent overburdening the writer and overwhelming the reader.

Page 13-14, paragraphs 46-52 - Sensitivity, stress testing and scenario analysis

We have concerns with the direction these paragraphs have taken to deal with the issue of risk and uncertainty, for many of the same reasons we had concerns with paragraph 45. We suggest that the IAIS not dictate the exact series of stress tests and scenario analyses required to be disclosed. Instead we recommend a flexible disclosure format that requires disclosure of the

⁴ Note that measurement uncertainty and runoff uncertainty are two separate and distinct concerns. Measurement uncertainty concerns the difficulty of estimating the mean or a given percentile of a distribution. Runoff uncertainty deals with the fact that we are essentially dealing with random variables, such that the final result can be very different from the mean of the distribution. When actual results are different from the original provision, it could be the result of one or both of these causes.

⁵ Note that this discussion about assumptions is equally applicable to a required disclosure of estimation methodologies.

major sources of uncertainty, both with respect to business currently on the books of the insurer and that anticipated to be written in the near future.

One of the difficulties with these paragraphs is that they implicitly assume a relatively simple and straightforward approach is used to estimate a non-life insurer's prices or aggregate technical provisions. The reality is that a large non-life insurer can perform liability analyses on over two hundred separate product/coverage/market segments using a variety of techniques. The analysis of pricing is not any simpler. A manual of all the rates for all the products sold by such insurers would be hundreds of pages long, before including the dozens of separate rating factors applied to those rates (e.g., factors for different policy limits, different deductibles, different exposure types such as vans versus long-haul trucks). For some of those segments or products it may be possible to perform a simple scenario/sensitivity test based on a 1% change to frequency, severity or inflation. But for many of those segments or products, such individual assumptions may not be an explicit part of the pricing or technical provision analysis.

Given this complex situation, a detailed list of required sensitivity disclosures for insurance liability or pricing risk would probably be either irrelevant or unfeasible (or both) for many insurers. We recommend instead that the required disclosures be directed towards those most representative of the risks faced by the individual insurer. Examples such as the impact of a 1% increase in frequency can be given, but should not be required unless they are the most effective approach for the insurer performing the disclosure.

Page 13, paragraph 46, first sentence, editorial

Assuming that the first sentence remains in the next draft, the wording would be more readable if changed to the following:

“Sensitivity, stress tests and scenario analysis performed by the insurer should incorporate some analysis that considers the insurer’s unique risk profile ...”

Cover letter questions

The following are the questions asked in the IAIS cover letter accompanying the draft standard, with the IAA response.

Should this standard apply to captive insurers?

IAA response: Yes, as many captives have the potential to compete with the more traditional insurance companies and to insure risks beyond those of their affiliates.

Should credit insurance be included in the scope of this standard or should it rather be treated in the standard on disclosures on investment performance and risks, which the Subcommittee will start drafting in the very near future?

IAA response: The risk from all insurance products sold needs to be addressed in the required disclosures. Proposals have been made that would include credit insurance in the financial instruments reporting standard if it involves significant credit default risk, even if it also includes other risks such as morbidity. It is questionable whether the financial instrument disclosures will adequately address these other risks. Therefore, a

supervisor of such products may not obtain adequate financial (technical) performance information by relying solely on financial instrument performance requirements. Supervisors need to include such credit insurance policies in their own disclosure requirements.

Should disclosures on capital adequacy in relation to solvency requirements be added to the capital disclosures in the draft standard?

IAA response: Such disclosures are needed, provided that they do not result in disclosure of proprietary information that should be kept confidential by the supervisor.

Are the requirements for disclosure about sensitivity and stress testing appropriate or do they need to be changed or refined?

IAA response: Please see our comments relative to paragraphs 46-52, contained above. In general, we believe that the requirements suggested in the IAIS draft standard in this area need to be changed. We believe that standardized sensitivity and stress testing for such companies can easily produce information that is costly to produce and more misleading than informative. We recommend instead a more flexible approach in this area, as the risks faced by non-life insurers and reinsurers can vary significantly between companies.

Summary

We believe that the categories of disclosure chosen by the IAA will add greatly to the transparency of insurer's financial position, enhancing the working of Basel II's second pillar as applied to insurance. At the same time, we believe that many changes are needed to the originally proposed details for these disclosure requirements. Otherwise, the disclosures could produce a great deal of data but not as much information. There is also the danger that disclosures can be more misleading than informative, as can occur when disclosing only gross of reinsurance information in certain situations.

We recommend that the IAIS standardize the form of the disclosures where practical, but avoid the temptation to overstandardize where the products and/or risks do not lend themselves to such an approach. For example, products vary so significantly across countries that combining their results under one product definition may be more misleading than informative. Where standardization does make sense, electronic reporting of the information can make it possible to quickly and efficiently make comparisons across years and companies, both for regulators and for outside users of the information.

We also recommend that the IAIS coordinate to the extent possible their disclosure requirements with those being developed by the IASB.

We thank the IAIS for the opportunity to make comments on their draft standard on *Disclosures Concerning Technical Performance & Risks for Non-Life Insurers & Reinsurers* and look forward to successful issuance of a final standard.

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)
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 Aktuariuszy (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)