



**ASSOCIATION ACTUARIELLE INTERNATIONALE
INTERNATIONAL ACTUARIAL ASSOCIATION**

August 29, 2010

Mr. Robert Meindl
Chair, Reinsurance and Other Forms
of Risk Transfer Subcommittee
International Association of Insurance Supervisors
c/o Bank for International Settlements
Basel, Switzerland

Dear Mr. Meindl

Re: IAA comments on the draft ICP 13 Standards / Guidance on Reinsurance and other forms of risk transfer

In response to the request for comments on the June 28, 2010 IAIS draft ICP 13 Standards / Guidance on Reinsurance and other forms of risk transfer, I am pleased to transmit on behalf of the International Actuarial Association (IAA) our comments and recommendations.

These comments have been prepared by the Reinsurance Subcommittee of the IAA and have been reviewed by the Insurance Regulation Committee. 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 Reinsurance Subcommittee, Michael Eves, 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: IAA comments

cc: Mr. Sebastian von Dahlen
Ms. Ann Neale

**A Commentary on the
DRAFT ICP 13 STANDARDS / GUIDANCE ON REINSURANCE AND OTHER FORMS OF RISK TRANSFER
Released by the International Association of Insurance Supervisors: June 28, 2010**

International Actuarial Association

The International Actuarial Association (the “IAA”) represents the international actuarial profession. Our sixty-two 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 Reinsurance Subcommittee of the Insurance Regulation Committee, the members of which are listed in an Appendix to this statement. It has also been subject to the due process required for it to constitute a formal view of the IAA, and will be posted to the IAA’s official web site.

IAA Comments and General Remarks

General

The IAA believes that ICP 13 has greatly gained over its previous versions. We believe the significant reduction in scope has helped the paper focus on essence without loss of substance. We also note that alternative forms of risk transfer have become much more prominent in the ICP; this was probably the most relevant point of our previous comments, and we think this has now been appropriately addressed. We still have some comments to this section specifically which are listed further below.

Overall our comments focus on specific aspects and make suggestions, but we would emphasize that none of these points would exhibit a materially different understanding, or a factual disagreement with what is contained in the ICP.

Paragraph 7

We fully agree with the thrust of the section.

The text states that the relationship between consumers and insurers needs more protection than a B2B relationship, and it may be helpful to explicitly state that indeed in most countries this relationship is governed by applicable insurance law (while this is typically not the case in reinsurance).

Paragraph 9

We agree with the contents of this section.

We would like to point out, however, that as one reads through this, inevitably the question comes up what criteria can appropriately be applied to judge adequacy or acceptability of a reinsurance contract.

The IAIS may want to consider how to deal with this issue. While we are of the opinion, that further elaboration on criteria is probably not appropriate to be included in the ICP, one may want to consider making a reference to other (future) documents which may provide additional guidance.

Paragraph 12

In light of the comment made on Section 7, we would suggest rephrasing the section as follows:

“Reinsurance is defined in the IAIS glossary thus: “A reinsurance contract is an ~~insurance~~ contract...”

as otherwise one could erroneously assume that insurance law applies to reinsurance – which is not the case.

Paragraphs 12 - 16

These sections have defining character as they describe what reinsurance is. We were wondering whether it would not be more useful to create a separate chapter for this, or possibly include this part at the beginning of Chapter 2.

Chapter 2

We would propose to change the heading of the Chapter to “Objectives of Reinsurance” or “Definition and Goals of Reinsurance”, depending on inclusion of section 12 to 16 (see previous comment).

Paragraph 15

While we agree with the statement, we would point out that the situation is different under a retrocessional agreement with a cut through clause.

Paragraph 16

We suggest slight adjustments to the text as follows:

“A treaty is regarded as a reinsurance arrangement, if it cedes business which under local rules is accepted as ~~an insurance product~~. The treaty is only to be considered as a loan or deposit, if during its ~~regular~~ development, the cedant has the unconditional ..

The thinking behind the changes is that:

- a) the term “insurance product” is unnecessarily restrictive, and
- b) that the word regular has no evident meaning and can become subject to misinterpretation (eg regular could mean smooth, and scenario testing could be interpreted to mean irregular)

Paragraph 17

We are of the view that a slight rearrangement of this paragraph would serve as a better introduction to this Chapter. We also think that the way the chapter is built up, one should talk

about 10 (instead of 6) primary functions of reinsurance as this would be present in sections 17 to 26.

We suggest making the first 2 sentences a separate bullet, as follows:

“17. In purchasing reinsurance, cedants seek to improve their financial performance and security. There are ~~six~~ ten primary functions of reinsurance, and it is important for supervisors to understand the commercial rationale behind a reinsurance programme as part of making their assessment of its suitability.

Volatility

18. One function of reinsurance is to reduce volatility, and thus the uncertainty of the cedants pricing risks, by pooling. This is done to increase the probability of survival of the cedant over a given time.”

Chapter 3

The numbering order seems to be inconsistent with preceding sections.

Paragraph 13.1.1

Typo: “A cedants reinsurance”

Paragraphs 13.1.4 and 6

We see potential for contradiction between those two sections: while subsection 4 claims need of approval for deviations from the strategy, subsection 6 seems to implicitly allow this “in certain circumstances”.

We propose deleting the part in brackets.

Paragraph 13.1.7

This section determines that the supervisor “can require the cedant to change the strategy where this is necessary”. While this is not an actuarially relevant topic, we wonder whether this authority is really desirable and appropriate, as it implies in its most extreme case that the supervisor starts running the company, and not management.

Paragraphs 13.1.9 and 10

While we agree with a requirement to have a process to identify and monitor acceptable reinsurance partners, we are not sure that maintaining a list is the only, or best way to do this. We also suggest dropping the second sentence, and instead include a statement that the universe of acceptable reinsurers is monitored and regularly reviewed, and that provisions be made that a special process might be used to deal with ad hoc, or particular, situations requiring immediate action.

Paragraph 13.1.11

We believe that cedant’s attention should not only be limited to aggregate exposures vis-à-vis reinsurance counterparties, but rather needs to control any aggregate exposures to specific counterparties. In particular, credit exposure to any specific company must be assessed in total. As an example, credit risk from a reinsurance counterparty is existent in reinsurance contracts, but also from investments into securities (e.g., bonds, shares, etc.) of this counterparty, or any

other perspective which can affect the balance sheet of the cedant relative to the specific counterparty. Equally, should the reinsurer have any exposures to the cedant, these should be offset to arrive at an overall net aggregate exposure.

Paragraph 13.1.17

Ceded and retro-ceded risks are not necessarily on the same basis as the reinsurer typically retro-cedes a multitude of risks, and not only the cedant's. Instead, the ceding company should be able to place comfort from the supervision of the reinsurer to determine whether the retrocession program puts the reinsurer at risk of meeting its obligations to cedants.

We suggest supplementing this section accordingly, or else consider omitting it altogether.

Paragraph 13.2.3

For reasons of clarity, we believe it should be pointed out that this section refers to accounting used for regulatory reporting.

Paragraph 13.4

Typo: include the word "and" in 3rd line to read: "upon the parties and finalize ..."

Paragraph 13.5

We fully agree with the contents of this section. However, in recognition of the entire document, its flow and level of detail, we wonder whether this section is maybe not too elaborate on the topic, drawing more attention than warranted and hence ebbing somewhat out of proportion with the other items.

Paragraph 13.6

We agree with the principle, but suggest changing the word "complexity" to "structure". Complexity suggests that these mechanisms are very difficult to understand and complex which is not necessarily the case. Oftentimes, reinsurance structures can be equally or more complicated as for many capital market structures, such as cat bonds, standardized structures including legal documentation exist.

Paragraph 13.6.2

We would want to point out that risk transfer to capital markets is not limited to the use of SPV's. In fact, there is a significant market for Insurance Loss Warranties which follow derivative formats (and have corresponding ISDA agreements), swaps as well as an emerging market for futures and options.

Paragraph 13.6.3

While we agree that functionally insurance securitization is an alternative, or surrogate, to reinsurance, it would be incorrect to regard it as identical. Notable differences are full collateralization of the limits (thereby greatly reducing counterparty risk), tradability and pricing (existence of a market where these assets can be bought and sold), etc. In fact, the ICP stresses the fact that insurance linked securities differ from reinsurance in section 13.6.7 itself, thereby presently contradicting itself.

Paragraph 13.6.5

We believe that the last bullet is already covered by the second bullet. Also, we are not aware of any transaction where the use of derivatives was allowed in the investment guideline, unless for the purpose of risk management (hedging).

Paragraph 13.6.7

We wonder whether the sections should not begin as follows: “Understanding the role of the parties ...”

First bullet: In our view, the sponsor and the (re)insured are typically one and the same party but we note that they can be different parties. Also, investors can typically only be known at the time when the transaction is placed. A key characteristic of ILS is their tradability and hence holders are often not known over time.

We believe that an important item the supervisor needs to understand is the degree of basis risk assumed by the sponsor. Unless a transaction is indemnity based, there is always some degree of basis risk assumed by the sponsor and this has immediate ramifications for the sponsor’s financial position in case of a loss. While section 13.6.11 elaborates on the point of basis risk, we believe it is important to be included here.

Paragraph 13.6.11

We suggest replacing the word “phenomena” with “metrics”.

Paragraphs 13.6.13 and 14

With respect to 13.6.13, we are uncertain as to the interpretation of this section.

We believe that it may be helpful to distinguish between unwinding the event of a loss, and the unwinding of a transaction reaching legal maturity (without a loss having occurred). While the latter case is usually simple and straightforward, the unwinding in a full or partial loss situation deserves close attention.

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