



**ASSOCIATION ACTUARIELLE INTERNATIONALE
INTERNATIONAL ACTUARIAL ASSOCIATION**

August 24, 2008

Mr. Steven Goldman
Chairman
Reinsurance and other Forms of Risk Transfer Subcommittee
International Association of Insurance Supervisors
c/o Bank of International Settlements
Centralbahnplatz 2, CH-4059
Basel, Switzerland

Dear Sir

Re: IAA comments on the IAIS Draft Standard on the Evaluation of Ceded Reinsurance

In response to the request for comments on the June 2008 Draft Standard on the Evaluation of Ceded Reinsurance, 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 Insurance Regulation Committee 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 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

**A Commentary on the
DRAFT STANDARD ON THE EVALUATION OF CEDED REINSURANCE
Released by the International Association of Insurance Supervisors: 26 June 2008**

International Actuarial Association

The International Actuarial Association (the “IAA”) represents the international actuarial profession. Our sixty 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.

Due Process

These comments have been prepared by the Reinsurance Subcommittee of the Insurance Regulation Committee, the members of which are listed below by name and association. 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.

Members of the IAA Reinsurance Subcommittee

Michael Eves	Chairperson
Desmond Kent Smith	Vice-Chairperson
Erik T Alm	Svenska Aktuarieföreningen
Luis Jesus Alvarez Marcén	Colegio Nacional de Actuarios A. C.
Réjean Besner	Society of Actuaries
Paul Braithwaite	American Academy of Actuaries
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Ashish Desai	Institute of Actuaries of India
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Monica Hainer	
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Charles Levi	Polskie Stowarzyszenie Aktuarialuszy
Eberhard Müller	Deutsche Aktuarvereinigung e.V. (DAV)
Branko Pavlovic	Udruženje Aktuara Srbije
A David Pelletier	Canadian Institute of Actuaries
John P Ryan	
Desmond Kent Smith	Actuarial Society of South Africa
Rolf Stölting	
Brian Valentine	

IAA Comments

The IAA welcomes the opportunity to comment on the latest draft of this important paper.

General

While Sections 4-6 could be more detailed, we note that the depth and length is relatively consistent with the other standards of the IAIS.

Section 1

Paragraph 1 –

- Suggest adding the word "*ceded*" before "reinsurance" in the second line.
- The 2nd sentence of this paragraph indicates that this standard discusses (a) policies and procedures that insurers should have in place (b) supervisory approaches, and (c) range of supervisory tools. We would suggest that the titles and subtitles contained in Sections 4 and 5 be edited to be more in line with the text contained here, or alternatively, the text contained in this sentence be edited to be more in line with the existing titles and subtitles.

Section 2

It could be desirable to have the subtitles and text in this section consistent with those contained in Paragraph 32 in of the Finite Reinsurance Guidance Paper #11 (i.e., Capacity, Stability, Catastrophe Protection, Financial and Expertise), and including as well Pooling, Fronting, and Withdrawal from a Class or Line of Business.

Paragraph 5 – The subtitle is unnecessarily long and somewhat unclear, and then the wording of the paragraph itself appears to deal only with part of what the title discusses. In line with the previous suggestion, this point could be better split into two, with briefer titles, as follows:

"Stability

N. Insurers may choose to protect themselves against adverse results which could arise from unusually high loss severity and/or frequency, which can result in fluctuation of results even when there are no extreme events. Reinsurance may be used in this way to enhance stability and predictability of net results, better meeting investors' expectations and hence optimizing financing costs."

"Catastrophe Protection

N+1. Insurers may also choose to protect themselves against catastrophic events which could severely affect their financial position. Catastrophe reinsurance protects stakeholders' interests in the event of such catastrophes, which can include natural catastrophes, terrorist events, and other extreme circumstances."

Paragraph 6 – The statement about reinsurance acting as an alternative to other forms of capital is true not just for this "rationale". Suggest then inserting the italicized words in the following: "In this context, *as indeed also in the case of the other rationales*, reinsurance acts in effect as an alternative to other forms of capital."

Paragraph 7 –

- On the 2nd line, suggest replacing "be viable" with "*operate efficiently*".
- Since the 3rd sentence ("Achievement of ...") seems to inappropriately imply that geographic diversification is possible ONLY on intra-entity pooling, we suggest replacing it with the following:

"Diversification effects derived from geographic attributes can exist within a single entity but in some circumstances this may not be possible because of local regulatory, tax or client requirements."

Paragraph 8 – We suggest the following three additional paragraphs be inserted before paragraph 8, given that they are not directly dealt with in paragraph 7 or elsewhere, and they are more intrinsic to the purpose of intra-group risk transfer than the current paragraph 8 (which would then be renumbered accordingly):

"N. Groups also use intra-group risk transfers as it can be more efficient to leave the capital where it is and move the risk to the capital. This may be for tax reasons, to avoid frictional costs on the movement of capital or because changes in business year to year could lead to inefficient readjustments of capital. It is usually easier to contribute capital to an entity than it is to release it."

"N+1. Intra-group reinsurance also has the capability of making capital more transferable in time of stress, through reinsuring business out of a stressed entity into a more stable one."

"N+2. Another benefit of intra-group reinsurance can be to provide protection to reduce the purchase of external reinsurance protection by local companies or offices when from a group perspective such external reinsurance protections are less cost-effective."

Paragraph 9 – On the 5th line, suggest replacing "reinsure" with "cede".

Paragraph 11 (and accompanying subtitle) –

Assuming the suggested edits above regarding the subtitles and their order are not made:

- Suggest moving this up closer to the front, perhaps before the Intra-group risk transfer item.
- Suggest changing subtitle (if not to "Financial" as suggested below) to *"Managing growth – relief of new business costs"*.
- Life reinsurers assume many risks other than just mortality; for example, morbidity, lapse, and investment risks. Suggest deleting the item in parentheses entirely.
- Much of such relief is provided with respect to the acquisition costs of new policies sold, regardless of whether they are new products or not. Hence, suggest the italicized insertion in the 2nd line: " ... towards the relatively high *policy acquisition costs and start-up costs* ..."
- Suggest adding an additional sentence within the same paragraph that discusses this purpose in a non-life context, as follows:
- *"As well, non-life companies in some markets utilize reinsurance (particularly proportional reinsurance) to "manage" or "finance" growth issues due to the statutory requirement to immediately expense acquisition costs."*
- Suggest adding another subtitle "Price" and a paragraph as follows:

"N. Insurers sometimes find the price offered by reinsurers very attractive. This can be because the reinsurer may have the benefit of lower cost of capital, greater diversification of risk, or a better understanding of the risk and be able to price it more appropriately. It may also be because of a competitive reinsurance market that drives prices down to aggressive levels."

Assuming instead that the suggested edits regarding subtitle are made, then:

- Change the subtitle to "*Financial*".
- That subtitle would have two paragraphs:
 - Paragraph 11 with the various edits suggested above.
 - A new paragraph to follow it, as described immediately above and repeated here, but without the subtitle Price:

"N. Insurers sometimes find the price offered by reinsurers very attractive. This can be because the reinsurer may have the benefit of lower cost of capital, greater diversification of risk, or a better understanding of the risk and be able to price it more appropriately. It may also be because of a competitive reinsurance market that drives prices down to aggressive levels."

Within Section 2, we suggest adding another subtitle and paragraph, as follows:

"Expertise

It is not uncommon for insurers to use reinsurance relationships as a way to gain access to reinsurers' specialized knowledge. Because the reinsurer may operate in geographical areas and/or lines of business beyond the insurance company's current operations, the reinsurer may be able to offer knowledge of products, jurisdictions, and/or lines of business into which the insurance company would like to expand. Many times the reinsurer and insurer will work together to develop a new offering and then share the results through their reinsurance relationship. The insurance company may also draw on the reinsurer's underwriting guidelines, claims expertise, policy wording guidance, etc."

Section 3

It is difficult to capture the different types and forms of reinsurance in a few paragraphs, particularly across both non-life and life sectors. At minimum, a footnote reference to Appendices I and II of the Guidance Paper 11 on Risk Transfer, Disclosure, and Analysis of Finite Reinsurance is suggested. Those appendices contain descriptions of the varieties of coverages that cannot be matched here. Another, perhaps better, alternative would be to make those two Appendices appendices of this Standard as well.

Paragraph 12 – In some life markets, the word treaty is applied to both what the non-life sector calls "treaty" and "facultative" coverages. The word "automatic" in such markets refers to what is called "treaty" here currently. Also, not just traditional reinsurance falls into the two categories mentioned. As well, some reinsurance falls in between the two. Hence, suggest replacing the first two sentences with the following:

"12. Generally speaking, traditional reinsurance falls into one of two categories: treaty (or "automatic" in some markets) and facultative. An automatic reinsurance treaty provides automatic protection for a pre-agreed book of underlying insurance contracts, subject to certain limits, whereas facultative coverages are placed on a risk-by-risk basis and are typically individually underwritten by reinsurers."

Paragraph 13 – Combining non-life and life together in one paragraph is extremely difficult. As written currently, it is inappropriate for life and requires minor modifications for non-life. At minimum, we would suggest that this paragraph be replaced by two paragraphs, one for each of non-life and life, as follows:

"N. Non-life reinsurance can be written on a proportional or non-proportional basis. In the former case the reinsurer agrees to bear a fixed proportion of any losses arising in exchange for a fixed proportion (not necessarily the same proportion) of the underlying premium. Under a non-proportional arrangement the reinsurer agrees to bear a specified amount of losses above a pre-agreed level in return for a specified premium. Catastrophe reinsurance is usually written on an excess of loss basis, protecting against an accumulation of losses arising from an event or series of events."

"N+1. Life reinsurance can also be written on a proportional or non-proportional basis. In the former (far more common), the ceding company establishes a retention, which may be a percentage or an absolute amount, with the remainder of the risk being ceded, typically on terms that remain unchanged until the termination of the underlying policy. The premium paid may be a "pure risk premium" or a proportion of the underlying policy premium, and the benefits paid may be merely the ceded portion of the mortality and morbidity risks or a range of the benefits payable under the underlying policy. Non-proportional reinsurance coverages provide for aggregate losses, on a stop-loss or catastrophe basis, rather than indemnification on individual policies."

Paragraph 14 – In the parenthetical comment on the 2nd line, we'd add "*or losses discovered*", to be footnoted as the other two items are, as follows: "*Losses discovered is where the reinsurer will meet claims in respect of losses discovered in the reinsurance policy period*".

Section 4

Paragraph 16 –

- Suggest replacing "underwriting risk" with "*insurance risk*".
- Existing last bullet point, insert the following after the word "mitigation":
 - "... *including rights of offset, collateral such as funds held, letters of credit, trust funds, etc.*)
- Add another bullet:
 - "*the extent the arrangement is required to cover extreme aggregate claims development and the solvency of the reinsurer in such a scenario.*"
- Suggest adding a further paragraph immediately following Paragraph 16:

"N. The measure of exposure depends on the rationale and the construction of the arrangement. For that part of the arrangement arranged to provide capital relief the exposure is the reinsurance asset of the deduction from the gross technical provisions. For that part of the arrangement designed to cover adverse claims development the exposure is the anticipated recoveries in the more extreme scenarios."

Paragraph 17 – We would note that the list of administrative issues here seems to relate to operational risks within the insurer rather than be a specific problem with the reinsurer. However, if it is to be retained, suggest the insertion after the word "include" on the 3rd line: *"failure to comply with underwriting standards and other conditions and warranties, ..."*

Paragraph 19 –

- In the 1st bullet, replace "the market practice of" by *"a practice in some markets of"*
- In the 3rd bullet, add within the parenthesis, following the word "arising"
"... , although the presence of brokers may also introduce additional operational risk"
- Add a further bullet:
 - *"... the desire on the part of reinsurers to maintain their reputations as good business partners."*

Section 5

Paragraph 22 – Suggest adding to the list: Chief Financial Officer, Chief Actuary, and Chief Risk Officer.

Paragraph 23 – In the "Link to Capital Assessment" item, suggest adding the following text in the sixth line after "rise to":

"... the triggering of certain risk-sharing features, such as additional premiums due under the reinsurance contract, or ..."

Paragraph 25 – In the context of "deficiencies in the reinsurance arrangements" in the 5th line, we would note that, at least with respect to deficient processes and controls, it is far more important to remedy the deficiency than to merely require more capital. Capital charges tend to be arbitrary though they may provide incentives. For this reason, we'd suggest the following insert at the end of this paragraph:

"However, at least with respect to deficient processes and controls, it will often be preferable to have those deficiencies remedied than to require more capital, which can be a somewhat arbitrary approach to the issue."

Paragraph 26 – Suggest inserting at the end of the first sentence:

"... to a single reinsurer, or when the reinsurer is particularly exposed to the same risks on a broader scale, so that the probability of loss and reinsurer default are not independent. Supervisors should note that a spread of reinsurers is not a perfect solution to concentration as different reinsurers may be subject to the same events so that their default probability and loss given default are also not independent."

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)
Bulgarian Actuarial Society (Bulgaria)
Canadian Institute of Actuaries/Institut Canadien des Actuaire (Canada)
Actuarial Institute of Chinese Taipei (Chinese Taipei)
Institut des Actuaire de Côte d'Ivoire (Côte D'Ivoire)
Hrvatsko Aktuarsko Društvo (Croatia)
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)
Institute of Actuaries of India (India)
Persatuan Aktuaris Indonesia (Indonesia)
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)
Lietuvos Aktuariju Draugija (Lithuania)
Persatuan Aktuari Malaysia (Malaysia)
Colegio Nacional de Actuarios A. C. (Mexico)
Association Marocaine des Actuaire (Morocco)
Het Actuarieel Genootschap (Netherlands)
New Zealand Society of Actuaries (New Zealand)
Den Norske Aktuarforening (Norway)
Pakistan Society of Actuaries (Pakistan)
Actuarial Society of the Philippines (Philippines)
Polskie Stowarzyszenie Aktuariuszy (Poland)

Instituto dos Actuários Portugueses (Portugal)
Academia de Actuarios de Puerto Rico (Puerto Rico)
Udruženje Aktuara Srbije (Serbia)
Singapore Actuarial Society (Singapore)
Slovenska Spolocnost Aktuarov (Slovakia)
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 Actuaires (Switzerland)
Society of Actuaries of Thailand (Thailand)
Faculty of Actuaries (United Kingdom)
Institute of Actuaries (United Kingdom)
American Academy of Actuaries (United States)
American Society of Pension Professionals & Actuaries (United States)
Casualty Actuarial Society (United States)
Conference of Consulting Actuaries (United States)
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