ASSOCIATION ACTUARIELLE INTERNATIONALE
INTERNATIONAL ACTUARIAL ASSOCIATION

May 8, 2009

Mr. Rob Curtis
Chair, Solvency and Actuarial Issues Subcommittee
International Association of Insurance Supervisors
Basel, Switzerland

Dear Sir

Re: IAA comments on the draft IAIS Standard and Guidance Paper on the Structure of Capital Resources

In response to the request for comments on the March 2009 draft *IAIS Standard and Guidance Paper on the Structure of Capital Resources for solvency purposes*, I am pleased to transmit on behalf of the International Actuarial Association (IAA) our comments and recommendations.

These comments have been prepared by the Solvency 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, Stuart Wason, or any other members of the subcommittee. The IAA will be pleased to develop these ideas further with you.

Yours sincerely

Yves Guérard
Secretary General

cc: Ms. Karen Doran, IAIS Secretariat

Attachment: IAA comments

Secrétariat: 800–150 Metcalfe, Ottawa, ON Canada K2P 1P1 ☎ 1-613-236-0886 1-613-236-1386
secretariat@actuaries.org / secretariat@actuaires.org — www.actuaries.org / www.actuaires.org

A Commentary on the
IAIS STANDARD AND GUIDANCE PAPER
ON THE STRUCTURE OF CAPITAL RESOURCES FOR SOLVENCY PURPOSES
RELEASED BY THE INTERNATIONAL ASSOCIATION OF INSURANCE SUPERVISORS: 8 MARCH 2009

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.

Due Process
These comments have been prepared by the Solvency 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
Our specific comments are outlined below.

Paragraph 8
We note that the IAIS is developing standards and guidance on the valuation of assets and liabilities, and observe that since certain types of both assets and liabilities (e.g., debt instruments) are relevant to the determination of capital resources, those standards and guidance are likely to be relevant to the current paper, even though as stated in paragraph 9 the current paper does not focus on valuation matters.

Paragraph 11
While we accept that harmonization with other financial sectors may be desirable, we would place greater importance on the need to reflect the risk profiles of insurance companies and their risk management, as reflected in the last sentence of this paragraph.

We are unsure of the meaning of the words "definition of the suitability of capital resources" in the third line. We agree that common definitions should be used where possible, but wonder whether what is intended here is harmonization of the criteria used to assess the suitability of capital resources?

Requirement 1
We would suggest this be strengthened to say "... to maintain adequate and appropriate capital resources ..." for consistency with paragraph 3, although we recognise that this is reflected in requirements 2 and 3.

Paragraph 19.1
It is also necessary to analyse the capital resources by type. While this is covered at the end of section 3.1 in paragraph 37, the need for this analysis could be made more prominent in this section.

Diagram in paragraph 23
The word “economic” is used here and in a number of other places in this paper, without definition, as a qualifier of value or valuation. We would prefer use of “market consistent” in accordance with paragraph 8 of the paper.

Paragraph 26
We feel that the use of “may” in two places in the last sentence is rather weak and would suggest the wording: “To the contrary, other liabilities which would not usually be considered as part of capital resources include liabilities such as ...”

We note separately that there may be a possibility that some creditors could in effect be capital providers depending on their nature and legislation.

Paragraph 27
Typo: paragraph 15, not 135.

Paragraph 28
You may wish to make some reference to reinsurance as a form of capital resource, either here or elsewhere in this section. There are some types of reinsurance such as surplus relief or those contingent on the emergence of surplus or on solvency, which might be classed as capital.

Paragraph 29
We think that supervisors should consider this point (not “may”). Companies need to consider the value of such assets in the scenarios (or stress tests) that define capital requirements, in line with the capital charge approach in paragraph 33.

It is not clear what “full economic value” means in the second sentence, but it does not seem to be market value if it is not the realisable value under normal conditions. The critical point here is the need to consider the value of all assets (and liabilities) in the adverse conditions underlying the capital requirements.

Paragraph 33
The capital charge approach seems more consistent with the total balance sheet approach, and with our previous comment. We are not sure what “the measurement error inherent in the determination of economic value” is – shouldn’t this be the value in the scenarios dictating capital requirements? (As mentioned above, the paper seems to use “economic value” instead of market consistent value in a number of places – is that deliberate?)

Paragraph 35
Where it is difficult to assess economic value (or market value), then there is a need for caution in the valuation. We do not think the last sentence of this paragraph adds anything – it is difficult to say whether or not this is a reasonable assumption.

Paragraph 37
At the very end, suggest amending to "... discussion following paragraph 24 above."

Paragraph 38
While we agree with most of the bullets here, we are not sure why the first one has been included, unless it is simply saying that a supervisor could permit use of a new capital instrument not covered by current rules.

Paragraphs 42 and 43
Two alternative approaches are briefly described here, for what appears to be a fairly fundamental matter. Is the IAIS able to provide firmer guidance on this matter, or at least set out the pros and cons of each approach? Paragraph 42 seems to be more consistent with current practice and with the thrust of paragraph 68.

This is an area where consideration of current regulatory practices could be helpful.

Paragraph 44
Should the rights of capital providers be included in this list (e.g., covenants, right to enforce wind up on default…)?

Paragraph 50
We suggest replacing the word "come" with "rank" in the third last line.

Paragraphs 54 and 55
Paragraph 54 may possibly be reasonable, but the interests of the capital providers and their right to walk away also needs consideration. Although this is covered by first bullet of paragraph 55, it is likely to be difficult to assess the ability and willingness of the relevant counterparty to pay up in adverse conditions. There is also the legal position to consider.

Paragraph 57
While we agree with the intention of this paragraph, the legal position may well be that in the event of insolvency the barriers between the funds fall away; it may also be possible to reattribute excess surplus in funds provided the policyholders in those funds have been treated fairly.

Paragraph 58
We feel that "Supervisors should determine a minimum period consistent with the duration of liabilities..."

Paragraph 59
In some territories it may be relevant to consider also the likelihood that capital is rolled over at its maturity date, though we recognise that this is not a contractual feature.

Paragraph 70 ff
One problem with the tiering approach not mentioned here is that if your tier 1 capital suffers a reduction, then typically the amount of tier 2 capital you can count towards capital requirements also falls, so you have a gearing effect. For example, suppose at time 1 capital requirements are 100, tier 1 capital is 60, tier 2 capital is 60, at least 50% must be tier 1, so surplus is 20. Suppose at time 1 tier 1 capital has reduced to 40, all else unchanged, then only 40 of tier 2 capital can be counted leaving a deficit of 20.

Paragraphs79, 80
This is a very important point, and is critical to permitting anything other than equity capital and free surplus to count towards capital requirements. We are though not convinced that the method adopted to set capital requirements (the example here uses VaR) should necessarily determine what capital resources may be used. Surely what justifies the second sentence of paragraph 80 is the terms on which any debt has been issued? – e.g., the terms may be that debt payments can only be passed in the event of insolvency, in which case the second sentence of 80 would apply in any event.

Paragraph 80 seems to imply that, for example, sub debt should not be permitted to count towards regulatory capital requirements in this example is that the intention?

It might be useful to consider those scenarios which would lead to each type and level of capital becoming impaired and absorbed. The credit rating (or aspiration) of the company relative to any implied credit rating of the regulatory standard might also be relevant. For example, in the United Kingdom the regulatory standard is generally regarded as equivalent to BBB, but most companies would have higher ratings.

Guidance on Individual Capital Assessment (ICA) in the UK (INSPRU 7.1.21) indicates that it is not necessary to allow for payments on debt subordinated to the interests of policyholders in the assessment. This is however the company's own assessment and no guidance appears to be given in relation to the regulatory minimum standard of 99.5% confidence level over one year, on which Individual Capital Guidance (ICG) is issued.

Appendix A

Members of the IAA Solvency Subcommittee

Stuart F. Wason	Chairperson
Philipp Keller	Vice-Chairperson
H.W.M. Van Broekhoven	Vice-Chairperson
Mohamed Adlioui	Association Royale des Actuaires Belges
Tenny Siu Pong Chong	Actuarial Society of Hong Kong
Anthony Coleman	Institute of Actuaries of Australia
Marius Du Toit	Actuarial Society of South Africa
Svetlana Golacheva	Russian Guild of Actuaries
Felipe Gómez Rojas	Instituto de Actuarios Españoles
R Kannan	Institute of Actuaries of India
Toshihiro Kawano	Institute of Actuaries of Japan
Dieter Köhnlein	Deutsche Aktuarvereinigung e.V.
Charles Levi	Polskie Stowarzyszenie Aktuariuszy
Helge-Ivar Magnussen	Den Norske Aktuarforening
Beverly S Margolian	Canadian Institute of Actuaries
Andreas Mehl	Aktuarvereinigung Österreichs (AVÖ)
Glenn Meyers	Casualty Actuarial Society
Harry Panjer	Society of Actuaries
David Paul	Faculty of Actuaries
Frank Rasmussen	Den Danske Aktuarforening
James E Rech	American Academy of Actuaries
Maria Jesus Romero Santo-Tomas	Col.legi d'Actuaris de Catalunya
Norma Alicia Rosas Rodríguez	Colegio Nacional de Actuarios A.C.
Richard Roth Jr.	Conference of Consulting Actuaries
Arne Sandström	Svenska Aktuarieföreningen
Nino Savelli	Istituto Italiano degli Attuari
Timothy Sheldon	Institute of Actuaries
Alkis Tsimaratos	Institut des Actuaires
Marcela Vítkov	Ceská Spolecnost Aktuárù
Eret Võsa	Eesti Aktuaaride Liit
Roberto Westenberger	Instituto Brasileiro de Atuária (IBA)
Igor Zoric	Udruženje Aktuara Srbije

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 Actuaires Belges (Belgique)
Instituto Brasileiro de Atuária (IBA) (Brazil)
Bulgarian Actuarial Society (Bulgaria)
Canadian Institute of Actuaries/Institut Canadien des Actuaires (Canada)
Caribbean Actuarial Association
Actuarial Institute of Chinese Taipei (Chinese Taipei)
Institut des Actuaires de Côte d'Ivoire (Côte D`Ivoire)
Hrvatsko Aktuarsko Drustvo (Croatia)
Cyprus Association of Actuaries (Cyprus)
Ceská Spolecnost Aktuárù (Czech Republic)
Den Danske Aktuarforening (Denmark)
Egyptian Society of Actuaries (Egypt)
Eesti Aktuaaride Liit (Estonia)
Suomen Aktuaariyhdistys (Finland)
Institut des Actuaires (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 Asociacija (Latvia)
Lebanese Association of Actuaries (Lebanon)
Lietuvos Aktuariju Draugija (Lithuania)
Persatuan Aktuari Malaysia (Malaysia)
Colegio Nacional de Actuarios A.C. (Mexico)
Association Marocaine des Actuaires (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)
Russian Guild of Actuaries (Russia)
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)
Society of Actuaries (United States)