AMERICAN ACADEMY of ACTUARIES

December 7, 2001

Ms. Frances J. O'Connor
Director-Federal/International Relations
Insurance Department
State of Connecticut
P.O. Box 816
Hartford, CT 06142-0816

Dear Ms. O'Connor:

Thank you for the opportunity to review the preliminary draft of the risk mappings created by the Federal Reserve and the National Association of Insurance Commissioners and for taking the time to review the project with us by conference call.

Our understanding is that your request for comments is limited to the Mapping of Life Insurance Risks and the Mapping of Property/Casualty Risks shown in the Comments Section of this draft, as the first two columns cannot be changed.

Insurance and banking are notably different, as you are well aware. These differences in some cases are basic--such as the types of risks covered, the risk assessment time periods, and the risk triggering events. Other important differences that need to be considered in understanding risks faced by banks and insurers include how they are identified, managed, and regulated. Examples of these differences include: (1) the use of a valuation actuary to assess asset adequacy, and (2) the different guarantee fund systems. In addition, these and other factors have also created differences among the various lines of insurance. The lengthy section at the end of each risk mapping of “Not Categorized” risks emphasizes this lack of conformity.

**General Comments**

1) Risk assessment should clearly quickly highlight and focus on the key risks. By attempting to fit ~~this~~ insurance risk assessment entirely into the banking model, this goal may be lost. Some items are very well done, some are repetitive, scattered or somewhat obscure. For example, market interest rate risk, market reinvestment risk and market asset/liability matching risks are all interest rate risks. This redundancy could lead others to a lack of understanding or a distorted view of the real risk.
2) Often, less critical risks are covered in great detail while the primary insurance risks appear to receive less attention. Many of the main Property/Casualty risks appear in the “uncategorized” section.
3) A separate document on the primary insurance risks may be a very useful addition to this document, if your focus is on understanding and terminology. These have been previously prepared for the NAIC by other interested parties for Life, Property/Casualty and Health Insurance with actuarial input.
4) We encourage you to continue to separately identify Life Insurance Risks from Property/Casualty and add a chart for Health, particularly Group Health. The current draft has a remarkable sameness in the wording, almost verbatim, in the Life and Property/Casualty comment sections. This implies a sameness in the pattern of risks faced that we believe is likely to be misleading. If you agree that risk exposures differ (in part due to different regulatory frameworks) and desire to highlight the differences, we will glad to assist you in that effort. We have not taken the time to do so, since that may be counter to your intent for this draft.

**Some samples of specific suggestions for possible improvement of this document are:**

1) Interest Rate Risk and Asset Liability Matching Risk – These are only separate risks if one views or manages the interest rate risk associated with interest sensitive product assets or liabilities separately. For life insurance they are managed in tandem, and interest rate risk is identified as asset liability mismatch risk. For the asset/liability category, we would suggest the comment "see interest rate risk" or vice versa. There is a separate interest rate risk, but it only applies to surplus funds-not liabilities.
2) Market Risk --Asset Market Value Risk --Comments should include the risks associated with fluctuating equity values.
3) Market Risk-"Stress Testing/Scenarios" is not a risk. It is a risk measurement tool. If this was intended to identify the risk of inaccuracies of the models used for this purpose, we believe it should be in the Operational Risk.
4) Market Risk - Basis risk is usually associated with hedging transactions where the performance of the hedging instrument does not exactly match the performance of the risk being hedged, because of differences between the risk being hedged and risk underlying the performance of the derivative instrument.
5) Liquidity risk is considerably more than asset/liability matching risk. Recent discussions within the insurance regulatory and actuarial community have broken liquidity into the more traditional cash flow risk driven by interest rates, and the "stress" liquidity risk driven by a singular event which threatens the financial viability of the insurer. In addition, there are the normal day-to-day liquidity needs of any financial institution, managing how normal cash in and out flows interact with the longer horizon investment process. These are limited issues and of different character for Property/Casualty Companies.
6) Credit Risk/Invested Asset should include risk, if any, of a rating downgrade.
7) Legal Risk/Legal Risk should include the risk of an adverse ruling.

8) Risk of Acquiring Business should be added to Operational Risks (and would include pricing risk, underwriting risk, expertise, business concentration, etc.).

9) Operational Risk should include risk of damage to physical assets and business interruption.

10) Credit Risk-Business Credit Risk--This is not generally a policyholder owner risk for Life insurers. For Property/Casualty insurers, some policyholders do have obligations to insurers. For example, many commercial liability policies are written with deductibles of $250,000 or more. The insurer pays the entire claim and then seeks reimbursement from the policyholder. These reimbursement amounts can be very substantial.

11) Credit Risk/Concentration Risk seems to be the same as Asset Concentration Risk. Replace "unexpected" with "larger" losses. Credit Risk/Political Risk and Market Risk/Sovereign Risk also seem to be the same with different titles.

12) Not Categorized – Actuarial Risk – we believe this risk terminology should be eliminated (our preference) or redefined as part of the Pricing Risk. We believe the Pricing Risk as defined already covers this risk and no further comment is appropriate or needed. In fact, since the terminology used was created by the NAIC in this section, we would include all of it under two categories, Pricing Risk and Operational Risk. Competition risk is a key Property/Casualty risk and is a preferable characterization to the comment about underpricing to gain market share. Pricing risk for Life insurance has to do with guarantees--not necessarily with differences described here unless as a result, the guarantees can not be met. This includes pricing risks, reserve adequacy, rapid growth, business start up, mortality et al.

13) Not Categorized -Manipulate pricing assumptions vs. Economically correct reserves terminology is either unclear or inappropriate.

As noted earlier, we applaud the NAIC and Federal Reserve efforts to map insurance risks into bank risks and think this draft is a good start at this process. We appreciate this opportunity to comment on this draft and look forward to working with you to improve it further.

If you need any further assistance please contact Meredith Detweiler, Financial Reporting Policy Analyst at 202-223-8196 or detweiler@actuary.org.

Best Regards

James Reiskytl