



March 14, 2002

David G. Hartman  
Vice Chairman, Insurance Regulation Committee  
International Actuarial Association

C/o Chubb Insurance Company  
15 Mountain View Road, E015  
Warren, New Jersey 07061

Dear Dave:

Thank you for sending us the International Actuarial Association's draft document "Terms of Reference: A Working Party to Propose a Risk-Based Solvency Capital Structure for Insurance Companies," dated February 2002. We understand your group encourages comments from interested parties. In that regard, this letter is written on behalf of the American Academy of Actuaries Property/Casualty Risk-Based Capital Committee to provide some comments regarding the draft.

We believe that the charge contained in the "Terms of Reference" document describes an ambitious undertaking that can advance the discussion of international insurance regulatory issues, but is confronted by significant challenges.

Based on the current language, the draft appears to favor a probability of ruin approach for the risk metric that would form the basis of the risk-based capital structure. We are concerned that reliance on a single risk metric at this time is premature, and may unnecessarily restrict the working group. Other risk measures, including Tail Value at Risk and Expected Policyholder Deficit ought to remain in consideration. In particular, we think it is important that the working party continue to review risk metrics that reflect both the probability *and* amount of insolvency. We think that the amount of insolvency is important when comparing risks across products, jurisdictions, and time. This is especially true when those risks are dissimilar and characterized

by non-symmetric distributions, and when a combination of different risks can exist within a single insurance company.

We agree that the working party should consider the work that is currently underway concerning related efforts (e.g., the Basel Accord) because this research adds valuable insights. However, we suggest that the working party not be constrained to develop something similar unless it “proves impossible”. While there is undoubtedly convergence occurring to some degree throughout the international financial services industry and the concept of uniform risk-based capital structures has a definite appeal, we believe that the “proves impossible” standard may be too high a threshold. It may result in failing to reject structures that are appropriate for the current state of other financial institutions, but are decidedly sub-optimal with respect to insurance companies.

We believe that it is important that any international risk-based capital structure provide a means for combining (or otherwise treating similarly) products with differing labels that have comparable risk characteristics. That structure will also, and perhaps more importantly, need to avoid treating products as similar which have the same labels but have substantially different risk characteristics.

We note that the current draft appears to contemplate the development of a single worldwide risk-based capital structure. While we applaud this effort, we believe that given the substantial global differences in underlying risks, legal environments, and regulatory regimes, a single structure is unlikely to be a reasonable objective at this time. This would be true even if a single worldwide insurance accounting standard existed. A single worldwide structure that is simple enough to be implemented by each jurisdiction may inadequately compare risks across jurisdictions. A single worldwide structure that can adequately compare risks across jurisdictions may be so overwhelmingly complex that it could not be easily implemented by any jurisdiction. We believe that the working group should keep this issue open, at least until its work concludes.

The American Academy of Actuaries is the public policy organization for actuaries practicing in all specialties within the United States. A major purpose of the Academy is to act as the public information organization for the profession. The Academy is non-partisan and assists the public policy process through the presentation of clear and objective actuarial analysis. The Academy regularly prepares testimony for Congress, provides information to federal elected officials, comments on proposed federal regulations, and works closely with state officials on issues related to insurance. The Academy also develops and upholds actuarial standards of conduct, qualification and practice, and the Code of Professional Conduct for all actuaries practicing in the United States.

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We thank the International Actuarial Association for this opportunity to comment on this “Terms of Reference” document. We strongly support the objective of risk-based capital research. Please do not hesitate to contact Stuart Suchoff at (949) 453-1881 should you have any questions or require additional information.

Sincerely,

Stuart B. Suchoff, Chairman

American Academy of Actuaries  
Property/Casualty Risk-Based Capital Committee

cc: Dean Anderson  
Ralph Blanchard  
Kay Cleary  
James Hurley  
Gerry Kirschner  
Alex Krutov  
Mark Mulvaney  
Prakash Narayan  
Greg Vass