



AMERICAN ACADEMY *of* ACTUARIES

November 24, 2009

The Honorable Barney Frank
Committee on Financial Services
2129 Rayburn House Office Building
Washington, DC 20510

The Honorable Spencer Bachus
Committee on Financial Services
B-371A Rayburn House Office Building
Washington, DC 20510

Dear Chairman Frank and Ranking Member Bachus:

On behalf of the Financial Regulatory Reform Task Force of the American Academy of Actuaries¹ I would like to take this opportunity to provide its perspective on the proposed Insurance Information Act, HR 2609, to create a Federal Insurance Office as it comes to the full committee for a vote. We recommend a change to the current draft which we believe will strengthen the effectiveness of the proposed Federal Insurance Office as it is presented under this legislation, and specifically, strengthen the regulation of systemic risk.

We strongly encourage you to include an explicit provision in the legislation to include important professional expertise by creating an Office of the Actuary. We believe a qualified actuary in the role of Federal Chief Actuary is critical to ensure proper oversight and guidance is provided to policymakers in the formation as well as the ongoing operations of the Federal Insurance Office. The insurance sector is subject to a range of potential systemic risks. Actuarial expertise is required to monitor and quantify these risks, including the risks unique to the insurance industry.

Actuaries are uniquely qualified through rigorous education and training to be expert in assessing the risks of insurance products and employee and retiree benefits and their effect on companies' overall financial strength relative to the risks assumed. Actuaries have been instrumental in the development of the regulations and risk management frameworks governing the insurance industry. Actuaries are required to adhere to the profession's Code of Professional Conduct that establishes high standards of conduct, practices, and qualifications.

The Congress has established two distinct Offices of the Actuary for Social Security and Medicare in recognition of the unique capabilities of the actuarial profession related to the management of these benefits. And the American Academy of Actuaries and four other actuarial organizations have communicated with Congress to establish qualification requirements for the chief actuary positions in these offices on par with the standards required of the profession. We believe the Congress has highly regarded their role in meeting the objective of providing fair and balanced, sound advice over the many years of their existence. We believe this reasoning should equally apply to the proposed Federal Insurance Office.

¹ The American Academy of Actuaries is a 16,000-member professional association whose mission is to serve the public on behalf of the U.S. actuarial profession. The Academy assists public policymakers on all levels by providing leadership, objective expertise, and actuarial advice on risk and financial security issues. The Academy also sets qualification, practice, and professionalism standards for actuaries in the United States.

While, during the recent economic downturn, the insurance industry was not immune to systemic risk emanating from the remainder of the financial services industry, state-regulated insurance companies were not the source of the systemic risk. We believe this occurred because of the well thought out regulatory and risk management structure of insurance entities related to the establishment of insurance liabilities and required solvency capital. The actuarial profession has been essential to the formation of this structure, both from regulatory actuaries and from our public interest commitment as a profession to provide objective and sound advice.

While insurers face certain risks similar to other financial services organizations, the long term guarantees made by insurers to contract holders are unique in the financial services industry. Consider the following:

- Insurers can have long-term liabilities of thirty years and longer in duration, where the full magnitude of the liability will not be known until the liability has been extinguished. The contingent nature of the liability requires an estimate of the value of the liability whose ultimate value will not be known until long after the original date of the policy insuring the claim.
- Product designs can be complex, with benefits contingent on a range of potential risks that may vary over time, as well as with certain guarantees made by the insurer.
- Insurers' risk management practices must weigh the capital needs of long-term guarantees made to contract holders against the need to produce sustainable profits in the short term.
- The accounting and financial reporting requirements for insurance are complex and are significantly different than those of other financial services industries.
- Certain specialty insurance products can also impact the financial system. Such products include: mortgage guaranty insurance; financial guaranty insurance; credit insurance; performance guaranty bonds; and other products with risk attributes similar to other financial products. It is expected that there will be more demand for these types of insurance products to replace some of the risk protection that financial products such as credit default swaps had provided.
- As the financial markets continue to recover, investors may seek alternative types of financial protection, such as those provided by insurance products or other products similar to insurance.

As brought to light, especially by the recent financial challenges, the tools and methods necessary to measure and manage the potential development of systemic risk throughout the financial services system, including insurance, require unique skill sets. Actuaries by their training and experience have the following skills needed to identify systemic risk throughout the financial services industry:

- Identify and evaluate current and future risk.
- Identify the data required to monitor and analyze risk.
- Identify data sources and design the tools to accumulate and analyze the data.
- Develop and implement methodologies to quantify risk and communicate findings and options for managing risk.

A qualified actuary leading the Office of the Actuary within the Federal Insurance Office would provide essential expertise and services without which, the FIO will not be able to adequately address its many unique challenges. Actuarial solvency and risk management methodologies will be important in structuring the Federal Insurance Office and creating effective systemic risk regulation.

In summary, we strongly recommend adding an Office of the Actuary to the Federal Insurance Office legislation and believe that it is critical to its success and effectiveness. The American Academy of Actuaries wishes to offer you its assistance in providing objective recommendations on the development of the infrastructure of the Federal Insurance Office as well as to the ongoing procedures to most effectively serve the stated purpose of the Office. We would welcome the opportunity to discuss these key concepts with you. If you have any questions concerning this letter please direct them to Tina Getachew, Risk Management and Financial Reporting Senior Policy Analyst, at 202-223-8196 or getachew@actuary.org.

Sincerely,



Jesse M. Schwartz
Chairperson, Financial Regulatory Reform Task Force
American Academy of Actuaries

CC: Members of the U.S. House Committee on Financial Services