May 1, 2015

Secretariat Support
International Association of Insurance Supervisors
CH-4002 Basel
Switzerland
Via email to lone.moerup@bis.org and tsuyoshi.saito@bis.org

Re: Draft Issues Paper on *Conduct of Business Risk and its Management*

To Whom It May Concern:

On behalf of the American Academy of Actuaries'[1] Enterprise Risk Management (ERM)/Own Risk and Solvency Assessment (ORSA) Committee, we are pleased to respond to your request for feedback on the International Association of Insurance Supervisors' (IAIS) draft issues paper *Conduct of Business Risk and its Management*, dated Apr. 22, 2015.

Generally, the ERM/ORSA Committee agrees with the considerations relating to the conduct of business risks in the paper. This is an important risk for companies to manage and for regulators to evaluate. As such, we do have some recommendations for consideration as described in the template below.

Thank you for the opportunity to comment on this issues paper. If you have any questions or would like to discuss our comments in more detail, please contact Lauren Sarper, the Academy's senior policy analyst for risk management and financial reporting, at +1 202.223.8196 or sarper@actuary.org.

Sincerely,

Patricia E. Matson, MAAA, FSA
Chairperson, ERM/ORSA Committee
Risk Management and Financial Reporting Council
American Academy of Actuaries

[1] The American Academy of Actuaries is an 18,500+ member professional association whose mission is to serve the public and 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.

Stakeholder Name: Patricia E. Matson, MAAA, FSA Chairperson, ERM/ORSA Committee, Risk Management and Financial Reporting Council, American Academy of Actuaries

E-mail/contact details: sarper@actuary.org, Lauren Sarper, Senior Policy Analyst, Risk Management and Financial Reporting, American Academy of Actuaries

Draft Issues Paper on Conduct of Business Risk and its Management (draft dated 22 April 2015)

Questions	**Answers/Comments**
1. Do you find that there are any important considerations relating to conduct of business risk that have not been adequately addressed in the paper?	The ERM/ORSA Committee generally agrees with the considerations relating to the conduct of business risks in the paper. This is an important risk for companies to manage and for regulators to evaluate. However, we believe the draft issues paper could benefit from a more detailed discussion in the introduction on what exactly "prudential" and "conduct of business" risks are. The terminology is not universally known or defined. For example, in the United States, the term "market conduct" instead of "conduct of business" is more widely used. In addition, we are concerned that the language in the introduction of the document implies that conduct of business risks have not been addressed prior to this draft issues paper. Insurance Core Principle (ICP) 16, Enterprise Risk Management for Solvency Purposes, and ICP 8, Risk Management and Internal Controls, both provide detailed guidance on corporate risk management, particularly through the development of ORSA and internal controls. A good ORSA would incorporate conduct of business risks. We recommend the introduction be revised to acknowledge past guidance on the matter and explain why additional guidance is necessary now.
2. Do you have specific comments on section 2.1 (linkages between conduct of business and prudential risks)?	We have some concerns with Annex I attached to section 2.1. Including a list of red flags without further guidance may suggest to regulators that, if any of the items are listed, it indicates a business risk. However, several of the red flags often are not direct indicators of a conduct issue. We would strongly suggest removing the list of indicators for Annex I in their entirety and replace the list with additional guidance on how to identify and use indicators of conduct risk. At the very least, we suggest adding additional language to the introduction of Annex I to clarify that the listed items are just suggestions and not necessarily indicators of business risk.

3. Do you find that any important sources of conduct of business risk are missing from the discussion in section 3?	We believe the paper provides a comprehensive list of the sources of conduct of business risk.
4. Can you provide examples of how insurers or intermediaries currently address conduct of business risks within their risk management frameworks (including what risk taxonomy or categorisation is used)?	Generally, U.S. insurers address the conduct of business risks through operational risk. The identification and management of operational risk (and the different types of operational risk) frequently is performed in conjunction with an insurer's internal audit function. Further, many U.S. insurers have leveraged the requirements of the Sarbanes-Oxley Act of 2002 to establish routine processes for monitoring operational risk. The legislation was passed by the U.S. Congress to protect shareholders and the general public from accounting errors and fraudulent practices in the enterprise, as well as improve the accuracy of corporate disclosures. In addition, some insurers consider such risks as part of strategic or reputational risk, which may be separately identified in the taxonomy. Companies often provide qualitative assessments for the fraudulent or poor behavior[2] of employees, intermediaries, or third parties. This is an important component of conduct of business risk, and we would suggest that the IAIS provide a more detailed discussion on this issue within the paper.
5. In your view, how can governance and culture of insurers and insurance intermediaries be influenced to better take into account conduct of business risks?	Executives need to make risk management a priority at their company. A greater focus on risk management will help reduce risky behaviors—including not holding appropriate assets to back needed capital, making investments in inappropriately volatile assets, etc.—and help address conduct of business risks within an organization. However, this may not be easy to accomplish under current practices, as executives could face disincentives or opposition to prioritizing risk management within a company. Several parts of the paper mention that companies should link incentives, including compensation or remuneration, to customer satisfaction. However, we suggest approaching such a policy with caution. Customer satisfaction is often a result of factors beyond an executive's control. For example, customers favor a health insurer that provides generous payouts for claims or an automobile insurer that does not raise rates, but those practices could be unsustainable and may render the company insolvent. On the other hand, customers may be satisfied with companies because they provide inexpensive products, but the customers may be misinformed about what is being sold.

[2] I.e., actions or behaviors that are either illegal or perceived as immoral or unethical, which can adversely impact the organization.

6. We would like to include more examples from IAIS member jurisdictions to illustrate the various points made in the paper. Could you suggest practical examples illustrating the messages in the paper originating from your jurisdiction?	One example in the U.S. relates to rating practices. There are significant regulatory protections in the U.S. to ensure that rates charged by insurers use risk classification approaches that are actuarially sound and appropriate based on prospective risk considerations, and do not unfairly discriminate based on characteristics such as age, gender, economic class, etc. (the specific characteristic vary depending on the coverage). Another example is sales practices. There are regulatory protections regarding the suitability of products for those insured, appropriate consumer disclosures, replacements of one insurance product with another, and illustrations of expected future policy values. Another example is the use of sliding scale premiums and commissions for reinsurance. Although sliding scales are not necessarily a concern, we question whether some sliding scale commissions and/or premiums for reinsurance have been a complicating issue in some run-offs and insolvencies in the U.S. property and casualty (P&C) insurance market and could illustrate a practice that may contribute to conduct of business risks.
7. Section 5 of the paper discusses the role supervisors can play in providing guidance relating to conduct of business risk. Could you suggest any examples of particular matters on which supervisory guidance could be useful?	The IAIS may want to consider providing additional details to the third bullet of paragraph 141 on page 29 on ways the supervisor could enhance customer awareness as a means of mitigating conduct of business risk. We would suggest that such information could include a straightforward, detailed comparison of the purpose, potential pros and cons, and a means of comparing the value of significant insurance products, etc.