



AMERICAN ACADEMY of ACTUARIES

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March 1, 2018

Actuarial Standards Board (ASB)
1850 M Street NW, Suite 300
Washington, DC 20036
Via email to: comments@actuary.org

Re: Proposed Actuarial Standard of Practice, *Capital Adequacy Assessment for Insurers, Second Exposure Draft*

On behalf of the Enterprise Risk Management and Own Risk and Solvency Assessment (ERM/ORSA) Committee of the American Academy of Actuaries,¹ I appreciate the opportunity to provide comments on the second exposure draft of the proposed actuarial standard of practice (ASOP), *Capital Adequacy Assessment for Insurers*.

The primary purpose of our review was to respond to your request for comments relating to the key changes from the first exposure draft. We have provided responses below to the five questions asked of commenters. In addition, we have included general suggestions for the improvement of the ASOP.

Request for Comments:

1. *Given the expanded scope, is the level of guidance appropriate?*

Yes, we believe that the level of guidance is appropriate given the expanded scope. Although risk retention groups and public entity pools that are not part of a larger insurance group may not be required to perform an assessment of their capital adequacy, the same standards of practices should apply if an assessment is performed.

2. *With respect to companies that have operations in multiple jurisdictions or as part of a group, does the exposure draft provide appropriate guidance?*

¹ The American Academy of Actuaries is a 19,000+ member professional association whose mission is to serve the public and the U.S. actuarial profession. For more than 50 years, the Academy has assisted 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.

In general, yes. In some sections, we believe that the guidance is too general to understand the array of possible contexts, especially for those who are new to capital assessment work. One example is Section 3.8 (a.2), “Differing capital requirements” across regulatory regimes. Clarification of what is intended by differing capital requirements will provide additional guidance such that an actuary can determine what may pertain to their situation. We think about the following examples when interpreting the meaning of “differing capital requirements,” although other practicing actuaries may have other interpretations:

- a) Differing threshold metrics (i.e., 99% TVaR, 99.5% VaR)
- b) Differing definitions of economic capital and available capital by jurisdiction
- c) Differing qualities of capital and corresponding limits on equity credit
- d) Differing minimum capital ratios
- e) Differing restrictions on transferring capital
- f) Differing time horizons for capital projections

Other readers may have alternative ideas on context.

Other sections that we believe would benefit from similar clarification:

- Section 3.2.e.1—The phrase “availability of capital” appears too broad. We suggest that it should address restrictions in transferring capital (fungibility, elimination of double gearing, etc.).
- Sections 3.2.e.3 and 3.2.e.4—Is it the intent that the transfer of risk include the potential for contagion risk among entities within the group?

Additionally, currency differences across an organization and the associated risks are important enough to itemize as a consideration. The capital supporting the exposures to risk may be in a different currency than the exposures themselves. The reporting currency of a group may be different from individual organizations.

3. *Do the changes in the exposure draft necessitated by eliminating liquidity and fungibility provide adequate guidance?*

Yes, we believe the guidance is adequate regarding the elimination of the terms “liquidity” (sections 3.1.f, 3.2.e.1, and 3.5.c) and “fungibility” (Section 3.1.d), as the language utilized within the guidance describes both of these considerations. However, we recommend that the ASB consider reintroducing those two terms into the standard, and defining them. This would help eliminate any confusion that could arise from practicing actuaries attempting to reference this standard while addressing the requirements and guidance associated with own-risk and solvency assessment (ORSA), Bermuda Monetary Authority (BMA), and the European Insurance and Occupational Pensions Authority (EIOPA), all of which utilize “liquidity” and “fungibility.”

4. *Are there situations in which the definition of capital in this standard would not be appropriate for a capital adequacy assessment?*

We believe the definition of capital in this standard would be appropriate for any capital adequacy assessment.

5. *Are the revised definitions of risk capital target and risk capital threshold clear and appropriate?*

Broadly speaking, the updated risk capital target and risk capital threshold definitions are clear and make sense, as do the sections elaborating on the additional considerations. Section 3.5, however, could be expanded so that two items could be further elaborated on:

- a. While numerous references are made to a range of practices in setting risk capital targets, there is no mention in the standard of practice that as firm size and complexity increases, expectations for setting capital targets rise from simple regulatory multiples to using stress tests to using stochastic models on a multiple valuation basis for larger more complex organizations. This is implied from a few comments but could be more explicit.
- b. While the risk capital target and risk capital thresholds are clear on their own, the relationship between these measures and the risk appetite and risk tolerance definitions from ASOP No. 46 could benefit from additional clarification.

We have included some general suggestions for the improvement of the ASOP:

General Comments:

Section 1

- Section 1.2:
 - Consider changing “life or health insurers, including fraternal benefit societies and health benefit plans” to “life or health insurers (including fraternal benefit societies and health benefit plans).” The sentence could be interpreted to mean that the word “including” starts a long list of entity types, which is not the intent.
 - The second paragraph could, perhaps, be used by an external stakeholder to imply they are permitted to request a capital adequacy assessment. Such assessments are typically confidential trade secrets. Please consider a sentence to explain that such assessments are typically confidential trade secrets and not viewable without the statutory authority to do so. And, either delete the example or clarify that it is a regulator with the statutory authority to make such a request.

Section 3

- Section 3.1.e
 - Consider adding “in a stress environment” after the end of the sentence “...in a timely manner.”
 - Consider identifying the quality of capital as a consideration in reviewing capital adequacy. The quality of capital (e.g., Tier 1, 2, etc.), whether it is jurisdictionally related or with respect to the vehicle used (debt, convertible debt, preferred stock, etc.) is critical in understanding how much credit is received in available capital.
- Section 3.1.f—Consider expanding on this item to clarify what is meant by “available resources” and “capabilities.”
 - For example, does “available resources” refer to available capital, available human resources, etc.?
- Section 3.2—Consider changing “following:” to “following, if applicable:”
- Section 3.2.f—Consider the following revision: “management actions in response to **adverse capital events**, whether at the group or individual organization level.”
- Section 3.2—Consider adding a new bullet point after 3.2.f that states “regulatory and/or stakeholder response to **adverse capital events**.”
- Section 3.3.b—Consider changing “mandated” to “regulatory.”
- Section 3.3.c—Consider adding a new bullet for: “Any differences between selected time horizon and any mandated horizon.”
- Sections 3.5.d and 3.5.e—Consider changing “and” to “and/or” because in every other case in the ASOP, it uses “targets or thresholds.”
- Section 3.6.2—Consider defining the phrase “plausible adverse conditions.”
- Section 3.7
 - Consider adding a bullet point to address the following issue: When management action is incorporated in capital planning, care must be taken not to assume that management has complete foresight into what is unfolding in the test environment.
- Section 3.7.d—Consider changing “available” to “publicly available.” This change would also be consistent with the language in Section 4.2.b.

Section 4

- Section 4.2.f—Consider changing “management” to “management, regulators, and stakeholders” to recognize their incorporation given that regulators and stakeholders are cited in Section 3.7.e.

Thank you for this opportunity to provide our views on the current draft of a proposed actuarial standard of practice, *Capital Adequacy Assessment for Insurers*. If you have any questions or would like to discuss this letter in more detail, please contact Nikhail Nigam, the Academy's policy analyst for risk management and financial reporting issues, at 202-223-8196 or nigam@actuary.org.

Sincerely,

Seong-Min Eom, MAAA, FSA
Chairperson, ERM/ORSA Committee
Risk Management and Financial Reporting Council
American Academy of Actuaries