



AMERICAN ACADEMY of ACTUARIES

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January 29, 2018

Mr. Jonathon Dixon  
Secretary General  
International Association of Insurance Supervisors  
c/o Bank for International Settlements  
CH-4002 Basel  
Switzerland

Re: Revised Insurance Core Principle (ICP) 16 Enterprise Risk Management (ERM) for Solvency Purposes and ComFrame material integrated with ICP 16

Dear Secretary General Dixon,

On behalf of the Solvency Committee of the American Academy of Actuaries,<sup>1</sup> I appreciate the opportunity to provide comments on the International Association of Insurance Supervisors' (IAIS) recent public consultation on Insurance Core Principle (ICP) 16, Enterprise Risk Management for Solvency Purposes and ComFrame material integrated with ICP 16, dated November 8, 2017.

Below are our comments and suggested changes to the draft ICP 16, outlined by section:

### ***General Comment***

The ICP should outline general roles and responsibilities related to an insurer's or group's risk management function and allow a company the flexibility to organize and carry out the roles and responsibilities of these activities based on its own unique characteristics. Such characteristics – including organizational structure, products offered, risk profile and regulatory requirements – vary widely among groups and jurisdictions, and often require different focus and emphasis from a risk management perspective. Prescribing specific activities that should be performed by specific areas within an insurer or group could be overly prescriptive and beyond the scope and intent of the ICP.

ICP 16 should be sufficiently flexible to recognize the variety that exists within the insurance industry and within a particular company. Throughout our comments (e.g., in our comment on

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<sup>1</sup> 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.

**CF 16.1a**), we suggest qualifications or clarifications where necessary to account for this variety (e.g., via the use of language such as “where applicable”).

### **16.0.1 Introductory Guidance**

Meeting policyholder obligations is the ultimate purpose of solvency regulation, and should be explicitly recognized as such. Therefore, we suggest adding “*as well as the insurer’s ability to meet obligations to policyholders*” at the end of the sentence describing what successful implementation results in, so it reads:

*“Successful implementation of ERM for solvency purposes results in enhanced insight into an insurer’s risk profile and solvency position that promotes an insurer’s risk culture, earnings stability, sustained profitability, and long-term viability, as well as the insurer’s ability to meet obligations to policyholders”*

### **16.1.7 Group Perspectives**

The phrasing in this paragraph does not seem to address non-insurance entities within a group. We therefore suggest removing the word “*insurance*” in the sentence “*For example, legally enforceable capital and risk transfer instruments between ~~insurance~~ group members may help with the effectiveness of its ERM framework for group-wide solvency assessment purposes.*”

**CF 16.1a. “The group-wide supervisor requires the IAIG’s ERM framework to be as consistent as possible across its legal entities”**

We suggest adding clarification or qualification to this requirement, such that consistency is only required where the entity’s risk is material to the entity’s and group’s overall risk profile, and the risk profile is sufficiently similar to the rest of the group to warrant a consistent framework. While we support application of a consistent ERM framework, the framework also should allow the flexibility to adjust for differences in regulatory requirements, risk profile, materiality, etc. Where an entity’s contribution to the group’s risk is not material or the entity has a risk profile very different from the rest of the group, a different approach to ERM may be more effective and efficient. Prescribing consistency in these instances may require actions that bring a cost but no or a negative benefit.

**CF 16.1.b “The group-wide supervisor requires the IAIG’s ERM framework to cover at least the following risks and the management of these risks in a cross-border context...”**

We suggest adding “Regulatory (Jurisdictional) Risk” to the list of risks required to be covered in the Internationally Active Insurance Group’s (IAIG’s) ERM framework.

### **16.2.7 – 16.2.14 Use of Models for ERM**

If the intent is to focus on how to address the use of internal models, we suggest carving out these bullets as an explicit “Internal Models” sub-section of the “Measuring, analysing, and modeling the level of risk” section. In addition, a number of these bullets could apply to external models as well.

**16.2.8 “An insurer may consider that the assessment of current financial resources and the calculation of regulatory capital requirements would be better achieved through the use of internal models.”**

As worded, this paragraph assumes that the use of internal models for regulatory capital requirements is always an option. That is not the case in many jurisdictions. This issue could be addressed by adding the phrase “(where permitted)” so it reads:

*“An insurer may consider that the assessment of current financial resources and the calculation of regulatory capital requirements (where permitted) would be better achieved through the use of internal models.”*

**16.2.17 “Where an insurance legal entity’s ERM framework is an integral part of the insurance group’s ERM framework, the techniques used to measure risks at group level should include those that are appropriate and adequate at the insurance legal entity level.”**

We suggest changing “should include” to “should consider.” Techniques for a specific entity may not be appropriate or material enough to be included at the group level.

**16.2.18 “...Scenario analysis considers the impact of a combination of circumstances to reflect extreme historical scenarios which are analysed in the light of current conditions....”**

Scenario analysis may consider the impact of possible scenarios that are not historical. While historical scenarios can be used to inform the development of current scenarios for study, they reflect the past environment. To the extent that the environment has changed (e.g., due to the sustained low interest rate environment, higher concentrations of exposure in catastrophe-prone areas, climate change, or new products such as cyber insurance), historical scenarios may be inappropriate or deficient for use in analyzing current or future risk. As such, we recommend broadening the language in this sentence to read:

*“Scenario analysis considers the impact of a combination of circumstances to reflect extreme historical or other scenarios which are analysed in the light of current conditions”*

**16.2.19 “Stress testing and scenario analysis should be carried out by the insurer to validate and understand the limitations of its models. ...”**

Stress testing and scenario analysis are useful tools that can supplement stochastic modeling. While these tools could serve to help validate and understand the limitation of models, their uses are broader and extend well beyond model validation. In addition, stress testing and scenario analysis are only part of a comprehensive suite of approaches to validating and understanding the limitations of models. The broader use of stress testing and scenario analysis as well as the limitations of using these tools only for model validation should be mentioned if this phrase is to be retained.

### **16.4.1 and 16.4.4 Liquidity risk**

We suggest modifying the language in 16.4.1 from “*should include*” to “*should consider including*,” so it would read:

*“An insurer’s risk appetite statement should ~~include~~ consider including qualitative statements as well as quantitative measures expressed relative to earnings, capital, risk measures, liquidity and other relevant measures as appropriate.”*

We also suggest adding “*as appropriate*” to the end of 16.4.4:

*“The supervisor should require risk capacity of the insurer to include the consideration of regulatory capital requirements, economic capital, liquidity and operational environment as appropriate.”*

These paragraphs would appear to make the presumption that liquidity risk will always be a major relevant risk category for every insurer, requiring separate mention in a risk appetite statement and explicit recognition in their evaluation of risk capacity. While liquidity risk is a key risk for many insurers, for certain insurers, such as non-life insurers with no call risk on their liabilities, liquidity risk may not be a major source of risk and may not need to be explicitly addressed in the risk appetite statement. We suggest that the ICP provide insurers with the flexibility not to include a particular risk in its risk appetite statement if the risk is immaterial.

### **16.5.1 “The insurer’s ERM framework should include an explicit ALM policy that sets out how...”**

We recommend adding “*to the extent appropriate*” to the end of the introduction of 16.5.1 This paragraph appears to have been drafted from the perspective of life insurers and the considerations set forth may not be necessary in the context of short duration non-life products where ALM is of limited concern. For these products, there is typically no interaction between assets and liabilities as the liabilities generally are a function of property damage or bodily injury rather than financial market variables.

### **16.6 “The supervisor requires the insurer’s ERM framework to include an explicit investment policy that: ... [2nd bullet] specifies ... how the insurer complies with regulatory investment requirements; ...”**

We suggest revising the second bullet under section 16.6 to “*summarizes how an insurer complies with regulatory investment requirements.*” As worded, this bullet could be read to imply that the insurer’s entire compliance policy must be embedded within its investment policy. We believe it would be inappropriate to embed the compliance framework within the ERM framework in this way.

**16.6.7 “... There should be explicit procedures to evaluate hidden and non-standard risks associated with complex structured products ...”**

We recommend this sentence be revised to include the phrase “*where applicable*” or something similar. There would be no need/requirement for explicit procedures to evaluate these risks if an insurer does not issue or invest in such products.

We also recommend the words “*hidden and*” be removed so that the sentence reads: “... *There should be explicit procedures to evaluate ~~hidden and~~ non-standard risks associated with complex structured products ...*” To the extent that a risk can be evaluated via an explicit procedure, it is not (or is no longer) hidden.

**16.7.1 “... An underwriting policy should cover ... claims settlement (both in terms of timing and amount) and expense control. ...”**

Underwriting policies for non-life insurers generally do not cover claims settlement and should only cover expense control where relevant to certain specifics of the underwriting process (such as the cost for on-site inspections). Therefore, we recommend that the reference to expense control in Section 16.7.1 be clarified as follows:

*“An underwriting policy should cover the underwriting process, pricing, claims settlement (both in terms of timing and amount) and expense control (where applicable and relevant to the expenses of the underwriting process).”*

We would also note that this is an operational risk and typically does not rise to the level of a solvency risk, which should be the focus of this ICP.

**16.7.2 “Control of expenses associated with ... payment of claims is an important part of managing risk especially in conditions of high general rates of inflation. ...”**

We would appreciate additional clarity on the concerns over expenses associated with claims payments.

**CF 16.7a.1 “The IAIG should clarify whether the data used are based on consolidation or on another aggregation method of the IAIG’s various entities. ...”**

It is not the data that might be aggregated, but the risk measures. Therefore, we recommend CF 16.7a.1 be revised as follows:

*“The IAIG should clarify whether ~~the data used are based on consolidation or on another aggregation method of the IAIG’s various entities~~ the risk evaluations are on a consolidated basis ....”*

***CF 16.7b Group-wide claims management policy.***

We believe that a group-wide claims management policy must allow the flexibility to reflect the fact that various factors, including products offered, claims environments and legal requirements regarding claims, vary by legal entity and jurisdiction. While a group-wide policy may require that local entities have procedures that cover such items, having the same procedures for all entities within a group may produce approaches or results that are ill-fitted to local environments. In addition, aggregating claims data across different currencies, products, and legal environments may produce data of little value for purposes of analyses.

We recommend that the requirement be reworded to specify that a group-wide policy should require local entities to establish procedures to address such items, but not require that group-wide procedures exist.

***CF 16.7d and CF 16.7e Group-wide actuarial policy***

As noted in our general comments, the ICP should follow a principle-based approach, and allow entities the flexibility to organize and carry out the roles and responsibilities of their risk management activities based on their own unique characteristics. In addition, CF 16.7d and CF 16.7e combine multiple functions that involve multiple areas of expertise. Therefore, we believe that these sections should be more permissive rather than prescriptive and explicitly permit reliance on the work of actuarial functions within the group’s individual legal entities, business lines etc.

***16.10 “The supervisor requires the insurer’s ORSA to: encompass all reasonably foreseeable and relevant material risks including, at a minimum, insurance, credit, market, operational and liquidity risks and (if applicable) additional risks arising due to membership of a group...”***

We suggest replacing “including, at a minimum” with “such as”. As mentioned in our comments above concerning paragraphs 16.4.1 and 16.4.4, liquidity is not always a material risk for all insurers. As such, companies should have the flexibility to opine on the materiality and inclusion in their Own Risk and Solvency Assessment (ORSA) of a particular risk, such as liquidity risk.

***16.12.6 “[Continuity analysis] should ... place ... emphasis ... on ... product design ... including embedded guarantees and options ...”***

We suggest adding “where applicable” to the above phrasing. Product design and embedded guarantees/options are typically not a solvency concern for non-life insurers’ continuity analysis.

***CF 16.12a.1 “These risks should include, but not be limited to: the ability of the IAIG and entities to handle significant or unusual growth or shifts in business volume...”***

We suggest clarifying this paragraph by revising the above phrasing to read as follow:

*“Examples of these risks ~~should~~ may include, but not be limited to:*

- *the ability of the IAIG and entities to handle significant or unusual growth or shifts in business volume that is part of the IAIG's business strategy...*

The paragraph as written requires an ORSA to evaluate these risks, even when they are not part of a group's business strategy, which is not appropriate. We also suggest that testing a strategy for unexpected growth and change in the mix of business should be considered/exercised as a best practice, but not necessarily as a prescriptive requirement in the ICP.

***16.13.2 "The supervisor should therefore assess the adequacy and soundness of the insurer's framework and processes by receiving the appropriate information, including the ORSA regularly."***

Given that an ORSA is a process, we suggest modifying this phrase to read "... receiving ... the ORSA report regularly".

***16.13.8 "The supervisor should require the results of the material stress testing, scenario analysis and risk modelling and their key underlying assumptions to be reported to them ..."***

This requirement may have the unintended consequence of overwhelming both the insurer and the supervisor with excessive processing and insufficient focus in their respective duties. It could easily be an administrative burden for the insurer and a distraction for the supervisor as it is not focused on problem areas needing regulatory attention. We recommend instead that any such reporting be on a summarized findings basis contained within ORSA reports, with additional detail that supports the summarized assumptions and findings to be available upon request.

We also note that the same paragraph suggests that the supervisor should have the authority to require that additional scenarios be run. This authority, if available, should be used with some measure of control and discretion so as not to create unnecessary burdens for insurers. Additional scenarios should be requested only for cause and in a thoughtful manner.

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Thank you for this opportunity to provide our views on the revised Insurance Core Principle (ICP) 16 public consultation. 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 +1 202-223-8196 or [nigam@actuary.org](mailto:nigam@actuary.org).

Sincerely,

Elizabeth K. Brill, MAAA, FSA  
Chairperson, Solvency Committee  
Risk Management and Financial Reporting Council  
American Academy of Actuaries

cc: Commissioner David Altmaier, Chair, ComFrame Development and Analysis Working Group, National Association of Insurance Commissioners  
David Sandberg, Chair, Insurance Regulation Committee, International Actuarial Association