AMERICAN ACADEMY of ACTUARIES

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The American Academy of Actuaries'[1] Financial Regulatory Reform Task Force submitted comments[2] on December 16, 2011 to the Federal Insurance Office (FIO) regarding its required report to Congress on how to modernize and improve the system of insurance regulation in the United States. The Task Force focused on areas where the actuarial skill set has unique application to insurance oversight: the regulation of insurance risk and, more specifically, systemic risk. This presentation summarizes the main points presented in the Academy's comment letter:

- The financial strength of the overall US insurance industry was largely left intact in the face of the most recent financial crisis largely because of the sound foundation of the risk-focused management practices and the state insurance regulatory system. A successful business model for an insurance entity relies on sound risk management practices operating in tandem with effective functional regulation. Effective functional regulation should emphasize the preservation of insurers' financial strength needed to fund insurance guarantees through capital and reserve requirements. The importance of insurers focusing on risk management while regulators focus on the preservation of financial strength should extend to all financial service providers.

- However, as with many dynamic markets, evolving practices or trends in the insurance sector and/or in regulations may result in the potential for systemic risk due to either insurers taking on risks and product offerings that are missing from insurance regulation oversight (as occurred with AIG) or due to a regulatory climate that allows for uneven or non-existent regulations for similar risk exposures (as occurred in the housing mortgage market), or allows for multiple jurisdictions to regulate only aspects of the enterprises with inadequate communication between regulatory authorities.

- The basis for any additional prudential regulation related to systemically important financial institutions (SIFIs) with insurance affiliates needs to be an understanding of the

[1] The American Academy of Actuaries is a 17,000-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.

[2] http://www.actuary.org/pdf/finreport/Academy_FIO_response_111219.pdf

specific underlying risks and business model, rather than based on a generic formula common to all companies across all segments of the financial services industry.

- Expanded oversight requires new tools, resources, and capabilities for regulators. Domestic and foreign regulators, as well as the NAIC and International Association of Insurance Supervisors (IAIS), are developing ways to expand their capacities to better anticipate and regulate emerging patterns of risks before the point at which adverse results of those risks can overwhelm insurance entities, the insurance sector or the financial services sector. Expertise within these regulatory functions is needed to effectively oversee, track, and remain proficient with the complexities of adaptive/evolving financial risk. These regulatory improvements would benefit from coordination at state, federal and international levels.

- An effective and coordinated regulatory system will need to efficiently do the following:
  - Implement a process to identify emerging risks and how they might be measured.
  - Assess the effectiveness of the regulatory process in mitigating systemic risk, including its need for increased resources, information, capabilities or new laws and regulations to respond to emerging trends.
  - Coordinate monitoring of insurance companies who are members of systemically important financial groups.

- The FIO, Financial Stability Oversight Council (FSOC), the Office of Financial Research (OFR), Functional State Regulators, NCOIL and the NAIC each have a critical role in developing and enabling the processes necessary to fully address emerging systemic risk. All those involved in the regulatory process must coordinate their oversight and regulation of the financial sector to accomplish the stated goals.

- The American Academy of Actuaries Financial Regulatory Reform Task Force will continue to work with all of these entities going forward to provide the actuarial expertise needed to execute these regulatory reform modernizations.

If you have any questions, please contact Tina Getachew, the Academy's senior analyst for risk management and financial reporting issues (202-223-8196; Getachew@actuary.org).