EXPOSURE DRAFT

Proposed
Actuarial Standard
of Practice

Capital Adequacy Assessment for Insurers

Comment Deadline:
January 31, 2017

Developed by the
Enterprise Risk Management Committee
of the
Actuarial Standards Board

Approved for Exposure by the
Actuarial Standards Board
September 2016
TO: Members of Actuarial Organizations Governed by the Standards of Practice of the Actuarial Standards Board and Other Persons Interested in Capital Adequacy Assessment

FROM: Actuarial Standards Board (ASB)

SUBJ: Proposed Actuarial Standard of Practice (ASOP), Capital Adequacy Assessment for Insurers

This document contains the exposure draft of a proposed actuarial standard of practice titled Capital Adequacy Assessment for Insurers. Please review this exposure draft and give the ASB the benefit of your comments and suggestions. Each response will be acknowledged, and all responses will receive appropriate consideration by the drafting committee in preparing the final document for approval by the ASB.

The ASB accepts comments by either electronic or conventional mail. The preferred form is e-mail, as it eases the task of grouping comments by section. However, please feel free to use either form. If you wish to use e-mail, please send a message to comments@actuary.org. You may include your comments either in the body of the message or as an attachment prepared in any commonly used word processing format. Please do not password protect any attachments. If the attachment is in the form of a PDF, please do not copy protect the PDF. Include the phrase “ASB COMMENTS” in the subject line of your message. Please note: Any message not containing this exact phrase in the subject line will be deleted by our system’s spam filter. Also please indicate in the body of the e-mail if your comments are being submitted on your own behalf or on behalf of a company or organization.

If you wish to use conventional mail, please send comments to the following address:

   Capital Adequacy Assessment for Insurers
   Actuarial Standards Board
   1850 M St. NW, Suite 300
   Washington, DC 20036-5805

The ASB posts all signed comments received to its website to encourage transparency and dialogue. Unsigned or anonymous comments will not be considered by the ASB nor posted to the website. The comments will not be edited, amended, or truncated in any way. Comments will be posted in the order that they are received. Comments will be removed when final action on a proposed standard is taken. The ASB website is a public website, and all comments will be available to the general public. The ASB disclaims any responsibility for the content of the comments, which are solely the responsibility of those who submit them.

Deadline for receipt of responses in the ASB office: January 31, 2017
2.3 Capital Adequacy Assessment—An assessment of projected capital of the insurer relative to its risk capital target or risk capital threshold.

2.4 Complex Insurance Organization—Affiliated group of individual organizations, primarily consisting of insurers, where the relationships among the organizations is constrained by governance, accounting, tax, foreign exchange, or legal or regulatory considerations.

2.5 Risk Appetite—The level of aggregate risk that an organization chooses to take in pursuit of its objectives.

2.6 Risk Capital Target—The organization’s preferred level of capital, which is expressed as a function of a measure of risk. This can result in a single value or a range. An insurer may establish multiple risk capital targets based on different risk metrics at any one time.

2.7 Risk Capital Threshold—The minimum level of capital necessary for an organization to operate effectively as selected by management and expressed as a function of a measure of risk. An insurer may establish multiple risk capital thresholds based on different risk metrics at any one time.

2.8 Risk Profile—The risks to which an organization is exposed over a specified period of time.

2.9 Risk Tolerance—The aggregate risk-taking capacity of an organization.

Section 3. Analysis of Issues and Recommended Practices

3.1 General Considerations—In designing, performing, or reviewing a capital adequacy assessment, the actuary should reflect the impact of the following:

a. the insurer’s risk profile and capital, the business and risk drivers, including the legal, regulatory, and economic environments in which the insurer operates, as well as any past and anticipated changes or trends in those environments;

b. the strategy and plans and the likelihood of their successful execution;

c. the timing of projected cash flows for both assets and liabilities, and the timing and intensity of future calls on capital and the means and ability to replenish it in a timely manner;

d. current resources, liquidity, fungibility, and capabilities plus the effect on capital adequacy of changes, or projected changes, in the risk profile;
e. correlation of risks and events, diversification benefits, and the uncertainty of the interdependence between risks; and

f. projections of future economic conditions.

3.2 Additional General Considerations—In designing, performing, or reviewing a capital adequacy assessment, the actuary should consider, or may rely on others who have considered, the following:

a. the insurer’s definition of risk, the primary risk metric(s) used in the risk management system of the insurer, the risk identification process, the risks identified by the insurer, relevant management risk reports, and the limitations of the analytical tools and processes that will be used by the insurer to evaluate and quantify each risk;

b. the insurer’s risk appetite and risk tolerance, as discussed in ASOP No. 46, Risk Evaluation in Enterprise Risk Management, including any conflicts between the risk profile and the risk appetite and how the risk appetite and risk profile is expected to change over time;

c. inconsistencies between the capital adequacy assessment and publicly released reports of, for example, loss and expense reserves, unearned premium reserves, or premium deficiency reserves, and the rationale for any inconsistencies. The actuary should consider the reserve amount(s) publicly reported by the insurer and, if available, any actuarial analysis or reports provided to management to estimation of reserves;

d. prior capital adequacy assessments; and

e. management actions in response to adverse capital events (see section 3.7).

If the actuary finds any of the above items to be material and relevant to the capital adequacy assessment, the actuary should document and disclose them.

3.3 Valuation Bases Underlying a Capital Adequacy Assessment—The actuary should review the selected valuation bases for assets and liabilities to determine whether consistent with and appropriate for the intended use of the capital adequacy assessment. When doing so, the actuary should consider the following:

a. criteria used by management for making risk and other financial decisions;

b. any differences between the selected valuation bases and any mandated valuation bases;

c. the time horizon(s) considered by management in decision-making;

Both the "criteria used by management" and "other financial decisions" seem too general and perhaps beyond the actuary's knowledge base. I suggest that this statement either be removed or qualified with something like "to the extent made available to the actuary".
d. the unique characteristics and implications of the selected valuation bases; and

e. any restrictions on assets or capital that are not otherwise reflected in the valuation bases.

3.4 Risk Capital Target or Risk Capital Threshold—When the actuary assists in the design of or the review of the appropriateness or applicability of risk capital target(s) or risk capital threshold(s) the actuary should reflect the following (on a historical, current, and prospective basis, as appropriate):

a. the valuation bases;

b. management’s objectives for capital (such as return on equity, insurer stability, acquisition plans, and infrastructure investment) and reasons they could change;

c. normal and adverse economic environments;

d. the time horizon over which the capital is assessed;

e. the methods used to aggregate results, including diversification benefits and the uncertainty of the interdependence among the risks; and

f. alignment with any existing risk appetite and risk tolerance.

3.5 Additional Considerations Regarding Risk Capital Target or Risk Capital Threshold—The actuary should consider, or may rely on others who have considered, the following:

a. the approach used to determine the “sufficient” level of capital (such as factors, historical averages, and economic capital models), as well as the uncertainty inherent in the approach;

b. the relative merits of using a range for the risk capital target versus a single number;

c. whether the insurer will be able to access additional capital if and when needed, including the fungibility and liquidity of sources of capital that are internal to a group of insurers;

d. the risk capital targets and risk capital thresholds established by the various members of the group; and

e. the relationship of risk capital targets and risk capital thresholds established by management and external stakeholders (such as rating agencies), as well as regulatory capital requirements, to the current capital and risks of the insurer.
3.6 Selecting Scenario Tests and Stress Tests—When an actuary includes scenario tests and stress tests in a capital adequacy assessment, the actuary should follow applicable guidance for scenario testing and stress testing in ASOP No. 46 and ASOP No. 47, Risk Treatment in Enterprise Risk Management. In addition, the actuary should consider the following:

3.6.1 Types of Tests—One or more forms of scenario tests or stress tests such as the following:

a. Reverse—Reverse-engineered test that creates an adverse capital event;

b. Deterministic—Tests to challenge the insurer in specific ways based on its unique exposures. For example, emerging risks may be considered using deterministic stress tests; and

c. Combination—Tests where multiple events that were tested in other scenarios happen simultaneously or sequentially.

3.6.2 Level of Adversity—Different levels of adversity such as the following:

a. periods of normal volatility;

b. plausible catastrophic events; and

c. extremely unlikely adverse conditions.

3.6.3 Sensitivity Testing—The actuary may use sensitivity testing to determine the applicability of the results of the scenario tests and stress tests under changing conditions, including the passage of time.

3.7 Incorporating Management Actions—When an actuary incorporates management actions in a capital adequacy assessment, the actuary should consider, or may rely on someone who has considered, the following:

a. effectiveness and applicability of prior management actions, given the time between when such actions were taken and the projection period, for example:

1. the magnitude of the impact of the prior action compared with the impact needed in the projection;

2. the differences in risk environment;

3. differences in the insurer’s enterprise risk management program and risk profile;
e. risks from the group to each individual organization, for example, reinsurance with aggregates or limits on a multi-company basis; and

f. risks from each organization to the group and the degree to which the complex insurance organization manages capital adequacy for each individual organization or primarily at the group level.

3.9 Additional Considerations Regarding Complex Insurance Organizations—The actuary should consider, or may rely on others who have considered, the following:

a. level of complexity and extent of information available across all aspects of the complex insurance organization;

b. levels of autonomy in selecting capital strategies for individual organizations within the complex insurance organization; and

c. the impact of various ownership interests, including the following:
   1. ownership splits, particularly between customers and shareholders;
   2. shares listed on multiple stock exchanges; and
   3. ownership concentrations.

3.10 Reliance on Data or Other Information Supplied by Others—When relying on data or other information supplied by others, the actuary should refer to ASOP No. 23, Data Quality, ASOP No. 38, Using Models Outside the Actuary’s Area of Expertise (Property and Casualty), and ASOP No. 41, Actuarial Communications, for guidance. When relying on projections or supporting analysis supplied by others, the actuary should disclose both the fact and the extent of such reliance, and the actuary should refer to ASOP No. 23, deeming such projections or supporting analysis as data covered by ASOP No. 23.

Section 4. Communications and Disclosures

4.1 Actuarial Communication—When issuing an actuarial communication subject to this standard, the actuary should consider the intended purpose of the capital adequacy assessment and refer to ASOP Nos. 23, 38, 41, 46, and 47. In addition, consistent with the intended purpose or use, the actuary should disclose the following in an appropriate actuarial communication:

a. material changes in the considerations listed in section 3.1 from a prior report, if any;
b. the key current and future business and risk drivers, including the legal, regulatory, and economic environments in which the insurer operates (see section 3.1(a));

c. the key elements of business and risk management strategies included in the capital adequacy assessment (see section 3.1(b));

d. a discussion of projected cash flows, future calls on capital, and the means and ability to replenish it (see section 3.1(c));

e. the businesses (insurance or non-insurance) that are included or excluded in the assessment, and the current resources, liquidity, fungibility, and capabilities of the insurer (see section 3.1(d));

f. the treatment of interdependence and diversification (see section 3.1(e));

g. the basis for projections of future economic conditions (see section 3.1(f)); and

h. the selected valuation bases for assets and liabilities, and why they are appropriate (see section 3.3).

4.2 Additional Disclosures—Consistent with the intended purpose or use, the actuary should make disclosures in addition to those in section 4.1.

a. If information regarding prior sources and uses of capital was available, the actuary should disclose the extent to which such information was reflected in the capital adequacy assessment, including any reasons for deviations from past trends in such sources and uses;

b. If the actuary had access to publicly available or internal reports and analyses, the actuary should disclose any material differences between such reports and analyses and the assumptions underlying the capital adequacy assessment;

c. If the actuary had a role in the design of or reviewed the risk capital targets or risk capital thresholds, the actuary should disclose his or her role and the rationale underlying the design or the results of his or her review (see sections 3.4 and 3.5).

d. If the actuary performed scenario or stress tests as part of the capital adequacy assessment, the actuary should describe the tests, including the type and levels of adversity, and summarize the results of the tests (see section 3.6);

e. If the capital adequacy assessment reflects specific management actions, the actuary should describe the actions, their impact on the capital adequacy assessment, and whether the actions could be effectively implemented in a timely manner (see section 3.7).
f. If the insurer is a part of a complex insurance organization, the actuary should describe the complex insurance organization and how the actuary reflected the insurer’s role in the complex insurance organization in the capital adequacy assessment (see sections 3.8 and 3.9).

4.3 Deviation from Guidance in the Standard—If the actuary departs from the guidance set forth in this standard, the actuary should include the following, where applicable:

a. the disclosure in ASOP No. 41, section 4.2, if any material assumption or method was prescribed by applicable law (statutes, regulations, authority);

b. the disclosure in ASOP No. 41, section 4.3, if the actuary states reliance on other sources and thereby disclaims responsibility for any material assumption or method selected by a party other than the actuary; and

c. the disclosure in ASOP No. 41, section 4.4, if, in the actuary’s professional judgment, the actuary has otherwise deviated materially from the guidance of this ASOP.

I was confused as to whether the section referrals in items (a) thru (c) referred to sections in this ASOP or in ASOP No. 41. I suggest the wording be changed to something like "In accordance with section 4.n of ASOP No. 41, if..."