Comment #1 – 12/2/16 – 3:14 p.m.

I am providing comments on the Exposure Draft of “Capital Adequacy Assessment for Insurers.” These comments reflect my personal views and may not be reflective of those of my employer.

Overall, I believe the Exposure Draft meets its intended purpose. I nonetheless have some specific areas of concern.

2.5. I continue to struggle with the definition of Risk Appetite. First, I find it to be very vague. Does it intend to refer to qualitative statements or quantitative metrics or both? Is it a measure of how much risk the organization currently has or how much it would like to have? The word “chooses” makes me think it is the former, but my experience with the term in practice is that it is the latter. If the definition is intended to refer to quantitative metrics, how might “aggregate risk” be measured? Also, in that case, how does Risk Appetite differ from Risk Tolerance? If the definition is intended to refer to qualitative statements, how does Risk Appetite differ from Risk Preference?

2.7 and 2.9. I am confused by the differences and interactions between Risk Capital Threshold and Risk Tolerance. I have always considered an organization’s Risk Tolerance to be a statement of the maximum amount of risk the organization is willing to take expressed as a combination of a threshold of some key metric and a probability. The organization’s Risk Capital Threshold is the minimum amount of capital that is needed given the current risk profile to satisfy the Risk Tolerance(s). The definition of Risk Capital Threshold allows this threshold to be stated as a function of a measure of risk which seems to me to convert it to a Risk Tolerance. To clarify, I define the Risk Capital Threshold to be the dollar amount of capital that corresponds to the function of a measure of risk defined by the Risk Tolerance(s).

3.1.e and f, similarly 3.4.c and e, similarly 4.1.f and g. It is not clear to me why economic environments and diversification benefits are singled out from all of the various assumptions that contribute to a capital adequacy assessment in these sections. It seems to me that all of the underlying assumptions are important, not just the ones related to economic conditions and diversification.

3.1.f. The use of the term “projections” in this bullet could be inferred to mean a single forecast of future economic conditions. I suggest clarifying that the range of possible economic conditions included in the modeling or scenarios is what is important if economic scenarios continue to be singled out among all of the modeling assumptions. (See previous comment.)

3.4.b. I believe that return on equity should not be a consideration in determining the Risk Capital Target or Threshold. The Target or Threshold should be a function of the risk of the organization. The ROE is a consequence of the selected level of capital and the amount of profit earned. Otherwise, an organization could intentionally choose a Risk Capital Target that is too low in order to inflate its ROEs.

3.4.c and 3.4.e. These two bullets reference components of the model used to assess capital and are not considerations in setting the Risk Capital Target or Threshold. They could be replaced by a reference to the overall uncertainty in the modeling process that might lead to a Risk Capital Target that is higher than might be required in the absence of model uncertainty.

3.5.e. Regulators could be included in the parenthetical remark along with rating agencies.

4.2.c. In a capital adequacy assessment, it is not clear to me why it is important for the actuary to disclose and discuss his or her role in setting the Risk Capital Targets or Thresholds. The actuary's input into that management or Board decision should be included in a separate actuarial report on that subject.

I am available to answer any questions regarding these comments.

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