TO: Actuarial Standards Board's (ASB) ERM Committee

FROM: NAIC ORSA Implementation (E) Subgroup

SUBJECT: Comments on the proposed Actuarial Standard of Practice (ASOP), "Capital Adequacy Assessment for Insurers"

The NAIC ORSA Implementation (E) Subgroup (hereafter "Subgroup") has reviewed the second exposure of the proposed ASOP titled "Capital Adequacy Assessment for Insurers" and would like to thank the ERM Committee of the ASB for its efforts in this area.

The Subgroup believes the ASOP will provide comprehensive and practical guidance to the actuaries involved in capital adequacy assessment work for insurers. The ASOP defines, for the first time, the scope of actuarial work regarding capital adequacy assessment and identifies a detailed list of factors for the actuary to consider that go beyond the mere quantification of capital, thus putting the capital adequacy assessment within the wider context of the insurer's business strategy execution.

The Subgroup believes this ASOP raises the bar for insurers and hopes the ASOP will contribute to elevating the quality of the ORSA Summary Reports that are filed with the departments of insurance, by encouraging insurance companies to take a more formalized and documented approach to the assessment of their own capital adequacy.

The Subgroup has organized and accumulated comments from various NAIC actuarial task forces on the five questions posed in the exposure within the attached Appendix A.

It is the Subgroup's interpretation of the scope of the ASOP that its guidance will assist actuaries employed by the Departments of Insurance to identify issues relating to capital adequacy assessment. The ASOP will enhance discussions between the insurer and regulator in the context of the financial analysis or examination of the company, as part of the risk-focused surveillance activity of the Department of Insurance.

The Subgroup looks forward to the adoption of this ASOP by the ASB and wishes for a fast adoption of the ASB to allow insurers and their actuaries to implement the requirements of the ASOP in their ORSA processes and ORSA Summary Reports ahead of the next filing deadlines. For any queries relating to this letter, please contact the NAIC Support Staff, Bruce Jenson (bjenson@naic.org) or Elisabetta Russo (erusso@naic.org).

Sincerely,

Kathy Belfi and Mike Yanacheak
Co-Chairs of the NAIC ORSA Implementation Subgroup

CC: NAIC Casualty, Life and Health Actuarial and Statistical (C) Task Forces

APPENDIX A

Regarding the five areas of the ASOP the ASB has expressively requested comments on, the Subgroup's comments are as follows:

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

The scope defined in section 1.2. includes "review" of a capital adequacy assessment. The Subgroup believes that this definition introduces an undesirable ambiguity.

"Review" may mean the capital adequacy assessment is reviewed annually, just like companies have actuaries who periodically review rates or reserves. Under this meaning, the reviewer, designer and performer are the same person or team. Alternatively, "review" could mean developing an independent response to a capital adequacy assessment presentation. The presentation is created after the assessment is completed and summarized. Such reviewers could include actuaries, who would be subject to this ASOP. Reviewers have interests and access to information that differ from the preparers' interests and access to information, reflecting their roles as peers, auditors, regulators, executives, board members, etc. As a result, the Subgroup believes that the responsibilities of an actuary involved in capital adequacy assessment should be different depending on whether they are acting in a "designer and performer" capacity or in an "independent reviewer" capacity. From this point on in the letter, when using the term "reviewing actuary", we are referring to those acting in an independent reviewer capacity, rather than in a designer and performer capacity. The Subgroup would like to see these responsibilities addressed separately in the ASOP and in particular, would like the ASOP to address the following two questions:

- What should a reviewing actuary do to comply with the ASOP?
- What is an appropriate set of activities for a reviewing actuary?

We would like to point out that, at time of the second exposure of this ASOP, the International Actuarial Association (IAA) has exposed the draft of the International Standard of Actuarial practice (ISA) number 6 "Enterprise Risk Management Programs and IAIS Insurance Core Principles". The use of "review" is similarly ambiguous in the section 1.2 "Scope" of this draft. However, subsequent sections of ISAP 6 specify reviewers' obligations (for example, sections 2.4.2 – ERM framework and 2.5 – ORSA). It is our understanding that ISAPs are model standards of practice and that the IAA encourages actuarial-setting bodies to maintain standards that are substantially consistent with the ISAPs. As such, we encourage consideration of the draft ISA in updating the ASOP.

We have set out below examples of activities that an actuary can be expected to perform when reviewing a capital adequacy assessment by reference to the various sections of the ASOP. Based on these examples, we have drafted a new section 3.11 that could be added to the ASOP to clarify the activities of a reviewing actuary.

Examples of activities for a "reviewing actuary":

a) Sections 3.1 and 3.2 [The actuary should reflect the "impact" of … and should "consider" ...]: the reviewing actuary does not have a context or generate a work product that would "reflect the impact." But a reviewing actuary can be expected to evaluate whether there is evidence in the presentation that the preparer appropriately reflected impact or considered the items listed in this section of the ASOP.

b) Section 3.3 [The selected valuation bases for assets and liabilities are consistent with and appropriate for the intended use of the capital adequacy assessment]: "valuation basis" is well understood among pension and life actuaries, but not among other actuaries and it should be further clarified. The ASOP should also clarify the responsibility of a reviewing actuary with regard to the "valuation basis"; for example, to assess whether the assumptions used are consistent with the intended use of the capital adequacy assessment.

c) Sections 3.4 and 3.5 [Review of the appropriateness or applicability of risk capital target(s) or risk capital threshold(s) and additional considerations]: a reviewing actuary can be expected to evaluate whether the risk capital target or threshold are reasonable and applicable and whether the presentation includes appropriate justification or thought processes for such target(s) or threshold(s).

d) Section 3.6 [Scenario tests and stress tests] and Section 3.7 [incorporating management actions]: a reviewing actuary can be expected to comment on whether the selected tests are appropriate and whether the calculations are accurate and if management actions are asserted to have a material mitigating effect, a reviewing actuary would focus on verifying those assertions.

e) Sections 3.8 and 3.9 [Insurers that operate in multiple jurisdictions and additional considerations]: The reviewing actuary does not have the context to generate a work product that would "reflect the impact" of items listed here. However, a reviewing actuary can be expected to evaluate whether there is evidence in the presentation that the preparer appropriately reflected impact or considered the items listed in this section of the ASOP.

Example of a new section 3.11 that could be added to the ASOP:

3.11 Review of Capital Adequacy Assessments designed and/or performed by others

a. If the assignment is to review a capital adequacy assessment prepared by others, an actuary should evaluate evidence in the presentation that the preparer(s) appropriately reflected impact or otherwise considered the items listed in Sections 3.1, 3.2, 3.8 and 3.9.

b. An actuary reviewing a capital adequacy assessment should assess whether the whole package of economic and other assumptions disclosed in the presentation is consistent with the intended use of the capital adequacy assessment.

c. An actuary reviewing a capital adequacy assessment may be expected to provide an expert opinion on the reasonableness and/or applicability of risk capital target(s) or threshold(s) in the presentation.

d. An actuary reviewing a capital adequacy assessment should evaluate whether the presentation includes appropriate justification or thought processes for any risk capital target(s) or threshold(s).

e. An actuary reviewing a capital adequacy assessment should evaluate whether the tests presented are appropriate and sufficient for the intended use of the capital adequacy assessment, and should confirm whether the test calculations are reasonable.

f. If the presentation and/or conclusions of a capital adequacy assessment are materially dependent on mitigating effects of management actions, an actuary reviewing that capital adequacy assessment should evaluate whether qualitative and quantitative evidence provided in the presentation adequately supports the assumed mitigation effects and whether evidence of past actions by management and endorsement of such actions by the Board of Directors supports the mitigating effect of future actions.

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

   Yes, the level of guidance is appropriate. We would recommend adding a paragraph to section 4.2 (Additional Actuarial Communication) that requires the actuary to disclose whether s/he had access to the capital adequacy assessment done at group level and how that information was used in the capital adequacy assessment of the insurer that is part of the group.

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

   The Subgroup believes that reference to fungibility is addressed by section 3.2.e [Additional General Considerations]. However, liquidity is not covered in any section of the ASOP and it should be addressed by adding a separate paragraph to the standard, given it is an important issue for consideration in a capital adequacy assessment.

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

   The Subgroup has not identified any such situation.

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

   Yes, the new definitions are sufficiently clear and appropriate. The Subgroup would like to add that the definition of Risk Appetite in section 2.5 could be further expanded to address the fact that, in practice, the risk appetite is often a combination of qualitative and quantitative statements, rather than just one level of aggregate risk.

Also, “collectability of additional capital” should be included in section 3.5.c to include those situations where the capital would, if collectible, come from pool or RRG pool members. The revised section would say “the actuary should consider whether the insurer will be able to access additional capital if and when needed, including the availability, COLLECTABILITY and sources of capital among affiliates”’.