AMERICAN ACADEMY *of* ACTUARIES

April 19, 2002

Mr. Norris Clark
Deputy Commissioner – California Department of Insurance
Chairperson, Statutory Accounting Principles Working Group
National Association of Insurance Commissioners
300 S. Spring St., 13th Fl.
Los Angeles, CA 90013

Re: Comment on IP 118

Dear Mr. Clark:

The American Academy of Actuaries' Life, Health, and Property/Liability Financial Reporting Committees would like to comment on the exposure draft of Issue Paper 118. Section 9.b.iv of the Issue Paper requires that investments in foreign insurance entities be valued using the statutory accounting principles promulgated by the National Association of Insurance Commissioners (NAIC) in the Accounting Practices and Procedures Manual (APPM). For a number of reasons, we believe that it is impractical and/or inappropriate to determine actuarial liabilities (e.g., reserves) of foreign insurers using the APPM. We recommend consideration of other more practical and suitable alternatives.

Life and Annuity Products

Life and annuity products sold by foreign insurers may vary significantly in product design from products contemplated by the APPM. The Standard Valuation Law and related Model Laws and Actuarial Guidelines have been developed with U.S. products in mind. In many cases, the products offered by foreign life insurers are very different from those offered in the U.S., and it could be difficult if not impossible to determine reserves for such products using U.S. requirements.

The APPM requires specific valuation mortality and morbidity assumptions in many instances. These assumptions were developed to achieve an appropriate level of conservatism in the reserves for companies domiciled in the U.S. There are many reasons that these assumptions may be inadequate or excessively conservative for foreign companies. A partial list of these would include underwriting standards, policy provisions (i.e., an incontestable clause), target market, distribution methods, and general level of population mortality.

The APPM requires specific valuation interest assumptions in many instances. These assumptions are specific to rates achievable in the U.S. The maximum allowable rates may have little or no relationship to the net investment portfolio yields of some foreign companies. Furthermore, restrictions on company investments will differ by country. Standard portfolios in foreign insurers may differ in composition by type of asset rendering our bond-based requirements inappropriate.

Adding the requirement that foreign insurance business must be valued under the requirements of the APPM will be a significant added expense for these entities. The additional effort will be compounded by the lack of statutory valuation software designed for foreign products. This will be particularly problematic for products distinctly different than anything offered in the U.S.

Health and Property/Casualty Products

We have found that similar issues of compatibility, suitability, practicality and cost/benefit exist with respect to health and property/casualty products, due to product design differences and other factors. For example, consideration of IBNR varies widely among countries and can be defined much more broadly (or restrictively) than in the APPM. Restructuring data into the APPM format is, at best, very difficult and extremely costly. Use of U.S. based factors would be inappropriate due to significant differences in product design, economic environment, and other factors.

Possible Alternatives

It is the opinion of the committees that the concepts found in the Preamble of the APPM, Conservatism, Consistency, and Recognition would be better served by allowing foreign insurance companies to value their actuarially determined items using some alternative basis. One option would be U.S. Generally Accepted Accounting Principles (GAAP), possibly with certain adjustments intended to provide a level of conservatism in accordance with the APPM. A second alternative would be to permit a qualified actuary to calculate a prudent reserve based on asset adequacy or other analysis (e.g., establish a reserve to provide for policy obligations under 70 – 90 percent of scenarios, in keeping with Unified Valuation Systems concept). A third alternative might be International Accounting Standards for Insurance (currently under development). You might consider allowing these or other bases as “safe harbor” alternatives to APPM under certain conditions. Further consideration of possible alternatives or safe harbors may be needed.

We would be glad to answer any questions you may have regarding our comments and/or provide additional assistance as appropriate in the circumstances. I can be reached at 312-879-2122 or michael.hughes@ey.com. We appreciate the opportunity to offer our comments on this important matter.

Sincerely,

Michael A. Hughes, Chairperson – Life Financial Reporting Committee

Darrell Knapp, Chairperson – Health Practice Financial Reporting Committee

Andrea Sweeny, Chairperson – Committee on Property and Liability Financial Reporting

cc: David Christensen, Jane Kipper